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A treatise on the law of private corpora



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A TREATISE
ON THE LAW
OF
PRIVATE CORPORATIONS.

BY
VICTOR MORAWETZ.

SECOND EDITION.

VOL. I.

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PREFACE.

THE first edition of this work was prepared according to a plan differing, in some respects, from that followed in any previous treatise on the same subject. The author was of the opinion, that the law relating to private business corporations could not be clearly understood, unless the fact were recognized that such a corporation is really an association formed by the agreement of its shareholders, and that the existence of a corporation as an entity, independently of its members, is a fiction; and that, while the fiction of a corporate entity has important uses and cannot be dispensed with, it is nevertheless essential to bear in mind distinctly that the rights and duties of an incorporated association are, in reality, the rights and duties of the persons who compose it, and not of an imaginary being. An attempt was therefore made to discuss and state the entire body of the law peculiar to private business corporations from this point of view.

The same general plan has been followed in this edition, and the author has not found it necessary to

change his views upon any important question. The order of the chapters has, however, been changed, partly for the sake of convenience, and partly because it was conceived that the present arrangement would be an improvement upon that adopted in the first edition. The numerous additions to the work would in any event have made a change in the section numbers indispensable.

The views of the author in respect to the proper treatment of the subject generally considered under the head of "Ultra Vires," have been confirmed by further reflection. The expression *ultra vires* has not been used in the text, partly because it is too vague to serve any useful purpose, and partly because the variety of meanings attributed to it lead to inevitable confusion of thought. In the chapter entitled "The Validity of Corporate Acts," an attempt has been made to distinguish the different principles of law upon which the legal effect of corporate acts depends, and to deduce from the authorities a series of rules by which the validity of transactions entered into by corporations in violation of their charters can be determined. The question what transactions corporations are authorized by their charters to enter into is considered in a separate chapter, entitled "The Construction of Charters."

A large amount of labor has been spent in the preparation of this edition. The entire work has been revised, much new matter has been added, and the

number of citations has been nearly doubled. The treatise has, however, been confined strictly to the law peculiar to private corporations, and collateral branches of the law have been touched upon only so far as is essential to a clear understanding of the main subject. In conclusion, the author desires to ask the indulgence of the profession for such imperfections as have necessarily resulted from the preparation of a work of this character amid the distractions of active practice.

NEW YORK, April, 1886.

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THE LAW
OF
PRIVATE CORPORATIONS.

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CHAPTER I.

THE FORMATION OF A CORPORATION.

§ 1. **Definition of a Corporation.**—A corporation was described by Chief Justice Marshall, in the *Dartmouth College Case*,¹ as “an artificial being, invisible, intangible, and existing only in contemplation of law.” A corporation has also been designated a legal entity, a creature of the law, a legal institution, a fictitious or political person. These and similar definitions have received the approval of many eminent authorities.²

According to Kyd, a corporation is “a collection of many individuals united into one body, under a special denomination, having perpetual succession under an artificial form, and vested by the policy of the law with the capacity of acting in several respects as an individual, particularly of taking and granting property, of contracting obligations, and of suing and being sued, of enjoying privileges and immunities

¹ *Dartmouth College v. Woodward*, 4 Wheat. 518, 636.

² For example, see *Head v. Providence Ins. Co.*, 2 Cranch, 127, 167; *Bank of United States v. Deveaux*, 5 Cranch, 61. 88, *per* Marshall, C. J.; *Ohio, &c. R. R. Co. v. Wheeler*, 1 Black, 286, 295, *per* Taney, C. J.; *Tippecanoe County v. Lafayette, &c. R. R. Co.*, 50 Ind. 97, 108; *Railroad Com'rs v. Portland, &c. R. R. Co.*, 63 Me. 269, 278; *Thomas v. Dakin*, 22 Wend. 73, 104, 107; *Merrick v. Van Santvoord*, 34 N. Y. 208, 218; *Thompson v. Waters*, 25 Mich. 214, 223, 224; *State v. Milwaukee, &c. R. R. Co.*, 45 Wis. 579, 592; *Brice on Ultra Vires*, 1; *Angell & Ames on Corp.*, § 1; *Dillon on Mun. Corp.*, § 9 *a*; *Civil Code of Louisiana*, § 418; *Civil Code of California*, § 283; *Code of Georgia*, §§ 1651, 1670; and see *infra*, § 1071.

Blackstone defined a corporation as “a franchise.” 1 Bl. Com. 123. See also 2 Kent's Com. 267, 268.

in common, and of exercising a variety of political rights, more or less extensive according to the design of its institution, or the powers conferred upon it, either at the time of its creation or any subsequent period of its existence.”¹

This definition is not inconsistent with that given by Chief Justice Marshall, when correctly understood. Kyd describes a corporation as a collection of many individuals authorized to act *as if they were one person*. Chief Justice Marshall, on the other hand, treats the collection of individuals constituting the corporation as a united body, and personifies it, while he considers the individuals who together compose this body merely as component parts. It is apparent that both definitions describe the same thing regarded from different points of view.

While a corporation may, from one point of view, be considered as an entity without regard to the corporators who compose it, the fact remains self-evident that a corporation is not *in reality* a person or a thing distinct from its constituent parts. The word “corporation” is but a collective name for the corporators or members who compose an incorporated association; and where it is said that a corporation is itself a person, or being, or creature, this must be understood in a figurative sense only.

The conception of a number of individuals as a corporate or collective entity occurs in the earliest stages of human development, and is essential to many of the most ordinary processes of thought. Thus, the existence of tribes, village communities, families, clans, and nations implies a conception

¹ 1 Kyd on Corporations, 13. See also *Thomas v. Dakin*, 22 Wend. 9, 69; *Gelpcke v. Blake*, 19 Iowa, 263, 268, *per* Lowe, J.; *People v. Assessors of Watertown*, 1 Hill, 616, 620, *per* Bronson, J.; *De Bow v. People*, 1 Denio, 9, 15; *Hightower v. Thornton*, 8 Ga. 486, *per* Lumpkin, J.; *Payne v. Bullard*, 23 Miss. 90; *Dartmouth College v. Woodward*, 4 Wheat. 667, *per* Story, J.; *Warner v. Beers*, 23 Wend. 103, 122–

124, 143–145, and authorities there quoted; *Railway Co. v. Allerton*, 18 Wall. 233, 235, *per* Justice Bradley. “Private corporations are but associatures of individuals united for some common purpose, and permitted by the law to use a common name and to change its members without a dissolution of the association,” *per* Justice Field, in *Baltimore, &c. R. R. Co. v. Fifth Baptist Church*, 108 U. S. 317, 330.

of these several bodies of individuals as entities having corporate rights and attributes. An ordinary copartnership or firm is constantly treated as a united or corporate body in the actual transaction of business, though it is not recognized in that light in the procedure of the courts of law. So, in numberless other instances, associations which are not legally incorporated are considered as personified entities, acting as a unit and in one name; for example, political parties, societies, committees, courts.

A legally constituted corporation is ordinarily treated at law, as well as in the transaction of ordinary business, as a distinct entity or person, without regard to its membership. In most cases this is a just as well as convenient means of working out the rights of the real persons interested; however, it is essential to a clear understanding of many important branches of the law of corporations to bear in mind distinctly, that the existence of a corporation independently of its shareholders is a fiction; and that the rights and duties of an incorporated association are in reality the rights and duties of the persons who compose it, and not of an imaginary being.¹

§ 2. **Different Kinds of Corporations. — Aggregate and Sole. —** The word "corporation" has been applied to various widely dissimilar classes of institutions. Thus, certain corporations, called corporations *aggregate*, are composed of many members; while others, called corporations *sole*, consist of a single person each.² The dignitaries of the Church in England are

¹ See *infra*, §§ 227 *et seq.*

What a corporation really is presents a question of fact, and not of law, and the solution of the question must be reached through the perceptions, rather than by abstract reasoning. Yet the question has given rise to a vast amount of fruitless metaphysical discussion, both among the civil law and common law writers. For a full collection of the civil law writers, see an essay entitled "Juristische Personen,"

by Zitelmann (published in Stettin, Jan. 5, 1873); and in briefer form, see Taylor on Corporations, §§ 1-9.

² *Overseers of the Poor v. Sears*, 22 Pick. 122, 125-129, *per Shaw*, C. J.

All the shares in a corporation aggregate whose shares are transferable may become vested in a single corporator. Under these circumstances, the corporation in legal contemplation retains its original character as a corporation aggre-

often cited as examples of corporations sole.¹ The same term has been applied in Massachusetts to a minister seised of parsonage lands to himself and his successors, in right of the parish.² The King, the Governor of a State, or any other public officer who is invested with any of the attributes of a corporation by reason of his official position, is in this respect a corporation sole.³

§ 3. *Private and Public Corporations.* — By another classification corporations have been divided into *public* corporations and *private* corporations. The difference between these two classes of corporations is radical, and hence they are in many instances governed by widely different principles of law. Private corporations are associations formed by the voluntary agreement of their members, such as banking, railroad, and manufacturing companies. Public corporations are not voluntary associations at all, and there is no contractual relation between the corporators who compose them; ⁴ they are merely government institutions, created by law, for the administration of the public affairs of the community. States, counties, and municipalities are examples of public corporations.⁵

gate. The several shares are treated as remaining distinct, and may at any time be redistributed by the sole owner. *Infra*, § 989.

A private banker doing business under the banking laws of New York is not a corporation in any sense of the word. *Codd v. Rathbone*, 19 N. Y. 37; *Bank of Havana v. Magee*, 20 N. Y. 355; *Hallett v. Harrower*, 33 Barb. 537.

¹ Kyd. on Corp., 20; 1 Bl. Com. 469; 2 Kent's Com. 273; *Ford v. Harington*, L. R. 5 C. P. 282.

² *Weston v. Hunt*, 2 Mass. 500; *First Parish in Brunswick v. Dunning*, 7 Mass. 445, 447.

³ Kyd on Corp., 20, 27, 28; 1 Bl. Com. 479; *Polk v. Plummer*, 2 Humph. 500, 506; *Governor v. Allen*, 8 Humph. 176; *Jansen v. Ostrander*, 1 Cowen, 670, 679.

⁴ *Infra*, § 24.

⁵ *Dillon on Mun. Corp.*, §§ 19-24; *Dartmouth College v. Woodward*, 4 Wheat. 518, 668, 669, *per* Justice Story; *Bonaparte v. Camden, &c. R. R. Co.*, 1 Baldw. 205, 222; *Rundle v. Delaware, &c. Canal Co.*, 1 Wall. Jr. 275, 290, 291; *Ten Eyck v. Delaware, &c. Canal Co.*, 18 N. J. L. 200; *Tinsman v. Belvidere, &c. R. R. Co.*, 2 Dutch. 148; *City of Louisville v. University of Louisville*, 15 B. Monr. 642; *Cleveland v. Stewart*, 2 Ga. 283. Compare *University of Alabama v. Winston*, 5 Stew. & P. (9 Ala.) 17; *McKim v. Odom*, 3 Bland Ch. 407, 417. In *State of Georgia v. Atkins*, 35 Ga. 315, it was held that the State was not a corporation within the meaning of an internal revenue law applicable

The fact that part, or even all, of the shares in a corporation are held by the State, does not necessarily render it a public corporation. Whether a corporation be public or private depends wholly upon its organization. Shares in a corporation may be held by a State in the same manner as by a private individual. This has been decided repeatedly with regard to various State banks. A State may undoubtedly establish a bank as a government agency subject to government control, thus giving it the characteristics of a public corporation, unless prohibited by the Constitution; but if a corporation is formed by the State with transferable shares, for the purpose of carrying on the banking business in the same manner as a private corporation, it must be classed as a private corporation in name as well as in fact.¹

§ 4. *Religious, Charitable, and Civil Corporations.*—Private corporations have been subdivided into *ecclesiastical* or religious corporations, *eleemosynary* or charitable corporations, and *civil* corporations.

Religious corporations are those which are formed for the advancement of religion, or the administration of church property for religious purposes. Abbeys and monasteries, in former times, and the various incorporated churches now in existence in the United States, are of this class.² The distinguishing feature of charitable corporations is, that they are formed for the administration of charitable trusts, and not for the profit of the corporators themselves; for example, corporations formed for the management of free hospitals and asylums for the relief of the poor, insane, blind, or otherwise helpless.³ Colleges and academies founded for the administration of private donations are governed by the same principles of law, and are ordinarily classed under the same

to persons and corporations. See also Alabama Certificates, 12 Op. Atty.-Gen. 176, 180; United States v. Railroad Co., 17 Wall. 328. Compare United States v. Fox, 94 U. S. 315; s. c. 52 N. Y. 530.

¹ Bank of United States v. Plant-

er's Bank of Georgia, 9 Wheat. 904, 907. *Infra*, § 35.

² Kyd on Corp. 22-25; 2 Kent's Com. 274; Terrett v. Taylor, 9 Cranch, 43, 46.

³ Kyd. on Corp. 25-27; 1 Bl. Com. 471; 2 Kent's Com. 274.

head.¹ A charitable corporation is merely a trustee or agent selected by the donor of the charity for the purpose of administering funds given for charitable purposes, and the beneficiaries of this trust are frequently the public, or parties outside of the corporation. The principles of law applicable to charitable corporations differ, on this account, in many respects, from those which apply to ordinary business corporations. The term "*civil* corporations" applies to all those incorporated associations which are formed for the temporal benefit of their members, such as railroad companies, manufacturing companies, banks, clubs, and other associations of a similar character.

§ 5. The associations falling within any one of the several classes which have been enumerated often differ greatly in their character and constitution. No well-defined dividing line can be drawn by which corporations of one class can be distinguished from those of another class; and sometimes the distinctive features of different classes of corporations are joined in one and the same association. The real nature of a corporation, in every case, depends upon the charter or articles of association under which it is formed, and must be determined by reference thereto; whether the association should be termed a public, or private, or religious, or charitable, or civil corporation, is simply a question regarding the meaning of those words.

§ 6. **Quasi Corporations.** — Associations and government institutions possessing only a portion of the attributes which distinguish ordinary private or public corporations have sometimes been denominated *quasi* corporations.

Towns and other political divisions, school districts, boards of commissioners, overseers, or trustees of the poor, etc., having authority to act and bring suit as united bodies without regard to their membership for the time being, are quasi corporations of a public character.² Individual public officers

¹ Kyd on Corp. 25, 26, 28; 2 nett, L. R. 5 C. P. 262, 272. Compare 1 Bl. Com. 471. Kent's Com. 274; Dartmouth College v. Woodward, 4 Wheat. 518, ² Kyd on Corp. 29; 2 Kent's 640, 681. See also Durant v. Ken- Com. 278; Denton v. Jackson, 2

having authority to sue, in their official capacities, upon contracts made with their predecessors in office, are examples of quasi corporations sole.¹ Joint-stock companies may be cited as quasi corporations of a private character. They are associations having some of the features of an ordinary common law copartnership, and some of the features of a private corporation. Their constitution varies greatly, and they may be found of every possible variety, from an ordinary copartnership to a corporation in the strictest sense of the word. Their real organization and character must in each case be determined by reference to the laws and articles of agreement under which they are formed: whether they are to be called copartnerships, or joint-stock companies, or corporations, is solely a question of definition.²

§ 7. **General Nature of a Private Business Corporation.**—This treatise will be confined to the law of *private, civil* corporations. The various associations of this general descrip-

Johns. Ch. 320, 325; North Hempstead v. Hempstead, 2 Wend. 109, 134; Jackson v. Hartwell, 8 Johns. 330; Rouse v. Moore, 18 Johns. 407; Jansen v. Ostrander, 1 Cowen, 670; Grant v. Fancher, 5 Cowen, 309; Riddle v. Proprietors of Locks, &c., 7 Mass. 187; Damon v. Granby, 2 Pick. 345, 352; School District in Rumford v. Wood, 13 Mass. 193; Trustees of Schools v. Tatman, 13 Ill. 27; Governor v. Gridley, Walker Ch. (1 Miss.) 328; Carmichael v. Trustees of School Lands, 3 How. Ch. (4 Miss.) 84; Commissioners of Roads v. McPherson, 1 Spear, 218; Justices of Cumberland v. Armstrong, 3 Dev. L. 284; Dean v. Davis, 51 Cal. 406; Levy Court v. Coroner, 2 Wall. 501; Cole v. Fire Engine Co., 12 R. I. 202; Slaughter v. Mobile County, 73 Ala. 134; Lawrence County v. Chattaroi R. R. Co., 81 Ky. 225. Compare Brown v. South Kennebec Agricultural Society, 47 Me. 275; Weld v. May, 9

Cush. 181; Jefts v. York, 10 Cush. 392; Commonwealth v. Green, 4 Whart. 531; State v. Towers, 38 Ohio St. 54; Gardner v. Board of Health, 10 N. Y. 409.

¹ Jansen v. Ostrander, 1 Cowen, 670; The Governor v. Allen, 8 Humph. 176.

² See Liverpool Insurance Co. v. Massachusetts, 10 Wall. 566; Maltz v. American Express Co., 1 Flip. 611; Dinsmore v. Philadelphia, &c. R. R. Co. (U. S. C. C.), 11 Phila. 483; Leonardville Bank v. Willard, 25 N. Y. 574; Waterbury v. Merchants' Union Express Co., 50 Barb. 157; s. c. 3 Abb. Pr. n. s. 163; Thomas v. Dakin, 22 Wend. 9; De Bow v. People, 1 Denio, 9; School District v. Insurance Co., 103 U. S. 707; National Bank of Schuylerville v. Van Dewarker, 74 N. Y. 234; Woods v. Figanieri, 3 Roberts, 609; Oakes v. Turquand, L. R. 2 H. L. 325. See *infra*, §§ 18, 969.

tion vary greatly in character and constitution. Hence it follows that no detailed description can be framed which would apply to all such companies with accuracy. But the general nature of an ordinary business corporation may be ascertained by comparing such an association with an association formed for similar purposes, but not incorporated, — namely, an ordinary business copartnership.¹

A trading corporation and a trading copartnership are in many respects alike. Each is an association formed by agreement of its members for the sake of pecuniary gain. In the one case, the objects of the company and the amount of its capital are set forth in a charter or articles of association; in the other case, the same purposes are attained by means of articles of copartnership.² But, while a copartnership is the result of an agreement resting wholly upon the general laws of contracts and agency for its validity, the agreement by which a private corporation is formed is of such a nature that it cannot be entered into and carried into effect *lawfully*, unless authorized by an act of the legislature.³ The formation of a corporation is prohibited by the common law in the absence of an enabling act of the legislature, or, in England, a charter from the King.

Partnerships, as well as joint-stock companies and corporations, are treated as collective bodies in ordinary business transactions. By the common law, however, an unincorporated association like a firm is not recognized as a united body having collective rights and duties, but only the individual members of the association and their individual rights and duties are considered. A corporation, on the other hand, is recognized by its corporate name, as an association having

¹ See *Thomas v. Dakin*, 22 Wend. 88, 89, *per* Cowen J.

² *Infra*, Chapters II., VI.

³ *Infra*, Chapter IX. § 715. See also § 628 *et seq.* In *Thomas v. Dakin*, 22 Wend. 109, Cowen, J., said: "Both partnerships and private corporations are conventional, so far as the members are concerned. The

difference consists in this: the former are authorized by the general law among natural persons, exercising their ordinary powers; the latter, by a special authority, usually, if not necessarily, emanating from the legislature, and conferring extraordinary privileges." See also *Pratt v. Pratt*, 33 Conn. 456.

collective or corporate rights and duties. The courts of *law* (as distinguished from the courts of equity) recognize an incorporated association in its corporate capacity only: they ignore the fact that a corporation is composed of shareholders having rights and duties as between themselves. For these reasons a corporation can sue its members and be sued by them at law as a collective body; but the rights of the several shareholders growing out of their membership in the company can, as a rule, be enforced only in the courts of equity.¹ It is true that in equity also a corporation is *ordinarily* treated as an entity, without regard to the several members who compose it; for this, under ordinary circumstances, is a just as well as convenient method of enforcing and adjusting the rights of the real parties interested. But this is not always the case; and it may be stated as a general rule, that a court of equity will recognize the true nature and constitution of a corporation whenever this becomes necessary in order that full justice may be done to the members of the company, or those who have rights against it.²

The members of a partnership, as a rule, are jointly liable for the debts of the firm. The members of a corporation are ordinarily not liable to creditors at all. At law the creditors of a corporation can proceed against the association only in its corporate capacity, and can reach only such assets as stand legally in the corporate name; in equity, however, all the assets of a corporation, whether legal or equitable, are considered to be impliedly pledged to creditors as security for their claims.³

It is a general rule applicable to all associations, whether incorporated or not, that a majority of the shareholders or members are impliedly authorized to bind the whole association by their vote while acting in the manner and for the purposes originally agreed upon.⁴ The ordinary business of

¹ *Infra*, § 227 *et seq.*; also §§ 1011, 1012.

³ *Infra*, Chapter X. § 759 *et seq.*

² *Infra*, Chapter V. § 227 *et seq.*, Chapter X. § 798 *et seq.*

⁴ *Infra*, Chapter VII. Part I., beginning § 454. See also § 621 *et seq.*

a corporation is managed on its behalf, and in its name, by particular agents, selected by vote of the shareholders. On the other hand, every act and every contract of a copartnership is, in legal contemplation, the act or contract of the individual members of the firm.

Partnerships are ordinarily composed of comparatively few members, and the relationship existing between the several partners is one of special trust and confidence. Each individual member of an ordinary copartnership is impliedly constituted agent of the other members in carrying on the common business, and the rights and powers of the several members cannot be transferred without the consent of all. This is not the rule in case of a corporation. Corporations are often composed of a large number of shareholders, who have no acquaintance with each other, and each shareholder is entitled to transfer his shares, together with the rights of membership which they represent, without first obtaining the consent of the other members.¹ The several shareholders in a corporation have no implied authority to act as agents for each other, or for the corporation; but certain officers or agents are selected, by vote, to act on behalf of the whole association and in the corporate name.²

§ 8. **By what Authority Corporations may be formed.**—Under the common law of England and the United States a corporation cannot be formed, like a partnership, merely by a contract between the individuals composing it. The right of forming a corporation and of acting in a corporate capacity must be treated as a franchise, or special privilege, which may not be assumed without a grant of authority from some governing power.³

In England the right of forming a corporation may be granted either by the King alone or by act of Parliament. The authority of the King to charter a corporation rests on prescription;⁴ and in former times the same power seems to

¹ *Infra*, §§ 163-165.

² *Infra*, § 483.

³ *Infra*, §§ 628-634; also Chapter 72 Ill. 397, 401.

IX., beginning § 715; 1 Bl. Com.

472; *State v. Bradford*, 32 Vt. 50, 53, *per* Redfield, J.; *Stowe v. Flagge*,

⁴ Kyd on Corp. 44.

have been exercised by the lesser feudal lords within their respective demesnes.¹

In the United States, where written constitutions define the powers of the several branches of the government, the power of chartering corporations belongs to the legislature only.² It is a power which belongs to the legislature, unless expressly taken away by the Constitution, and is incidental to the general power of making laws for the welfare of the State.³

§ 9. **Of the Power of Congress to charter Corporations.**—Congress has power to grant a charter of incorporation whenever this is an appropriate measure for carrying out any of the authorized purposes of the Federal government.⁴ The power of granting corporate franchises is not given to Congress in express terms by the Constitution, but it belongs to Congress as an incident to the powers expressly granted. Whether Congress can charter a corporation in any particular case, therefore, depends wholly upon the constitutionality of the ultimate object to be attained, and the fact that the formation of a corporation is really adapted to effect this object. If the object to be attained is within the authorized purposes of the Federal government, and the formation of a corporation is really *a means* of attaining this object, it is clear that the courts cannot presume to inquire into the necessity or the policy of the action of the legislature.⁵

¹ Kyd on Corp. 42.

² McKim v. Odom, 3 Bland Ch. 407, 417; Franklin Bridge Co. v. Wood, 14 Ga. 80.

³ Briscoe v. Bank of Kentucky, 11 Pet. 257; Bell v. Bank of Nashville, Peck (Tenn.), 269; Bank of Chenango v. Brown, 26 N. Y. 467.

⁴ McCullough v. Maryland, 4 Wheat. 316; Osborn v. Bank of United States, 9 Wheat. 738; Thomson v. Pacific R. R. Co., 9 Wall. 579, 588; Farmers', &c. Nat. Bank v. Dearing, 91 U. S. 29.

Congress has passed incorporation laws of great importance since the decision in favor of the constitution-

ality of the charter of the Bank of North America, in McCullough v. Maryland, *supra*; for example, the National Banking Acts, and the acts incorporating the Pacific Railroad Companies. See *infra*, §§ 964-967.

Congress may charter a savings bank in the District of Columbia, and the corporation so formed may by the comity of the States transact business throughout the Union. Hadley v. Freedman's Saving Bank, 2 Tenn. Ch. 122, 126; Williams v. Cresswell, 51 Miss. 817, 822.

⁵ McCullough v. Maryland, 4 Wheat. 316, 423. Compare Thomson v. Pacific R. R. Co., 9 Wall. 588.

§ 10. **Constitutional Limitations upon the Powers of the State Legislatures.**—In many of the States the legislature is prohibited by constitutional provision from granting corporate franchises except in accordance with certain prescribed rules. Thus, it is provided, in many instances, that no charter of incorporation shall be granted by special act, and that corporations shall be formed only in accordance with general laws.¹ It is clear that, under a constitutional limitation of this description, the legislature would have no power to legalize the existence of a corporation formed without proper authority, by passing a special act ratifying the claim of corporate franchises.²

In Ohio the Supreme Court held, under a constitutional provision that “the General Assembly shall pass no special act conferring corporate powers,” that a special act, giving the purchasers under a foreclosure sale of the property of a railroad company authority to organize and form a corporation with the same rights and franchises as belonged to the corporation whose property was taken, was unconstitutional and void.³ Under a similar provision of the Constitution of Nebraska, it was held that an act authorizing a particular school district to issue bonds for building a schoolhouse was unconstitutional.⁴

Under a provision of the Constitution of Iowa prohibiting the legislature from passing any special or local law “for the incorporation of cities and towns,” it was decided that the legislature could not enact a special law amending the charter of a city.⁵ A similar rule has been applied in other States.⁶

¹ Under the Constitution of New York the legislature has discretionary power to charter certain classes of corporations by special act, although general incorporation laws for that purpose be in force. *People v. Bowen*, 21 N. Y. 517; 30 Barb. 24; *United States Trust Co. v. Brady*, 20 Barb. 119; *Mosier v. Hilton*, 15 Barb. 657.

² *Oroville, &c. R. R. Co. v. Plumas County*, 37 Cal. 354. But an irregularity in the organization of a corporation under a general law may

be cured. *Central, &c. Ass. v. Gold Life Ins. Co.*, 70 Ala. 120.

³ *Atkinson v. Marietta, &c. R. R. Co.*, 15 Ohio St. 21. See *infra*, § 904.

⁴ *School District v. Insurance Co.*, 103 U. S. 707; *Clegg v. School District*, 8 Neb. 178; *State v. Cincinnati*, 20 Ohio St. 18.

⁵ *Ex parte Pritz*, 9 Iowa, 30; *Town of McGregor v. Baylis*, 19 Iowa, 43.

⁶ *San Francisco v. Spring Valley W. W. Co.*, 48 Cal. 493.

§ 11. On the other hand, it was held by the Supreme Court of Minnesota that a provision of the Constitution declaring that "no corporations shall be formed under special acts except for municipal purposes" would not prevent the legislature from extending the duration of corporate franchises previously granted to a company for a limited period of time,¹ or from altering the charter of a company incorporated as a mutual insurance company with authority to issue stock policies, so as to render it a stock company exclusively.² In a case before the Supreme Court of the United States it was held that a similar prohibition of the Constitution of Alabama would not prevent the legislature of that State from passing an act authorizing a railroad company to change its name and to purchase the railroad and franchises of another company.³

§ 12. The line of distinction between an alteration of the charter of a corporation and a change involving an entire reorganization and the formation of a new company, is entirely conventional. Strictly speaking, every alteration implies the formation of a corporation differing from that which existed before; but it would not be termed the formation or creation of a corporation in the ordinary use of language. A grant of property to a corporation, or of franchises which may be accepted and exercised without altering the contract of the shareholders,⁴ could certainly not with propriety be called *the creation* of a corporation. Hence in *Southern Pacific Railroad Co. v. Orton*,⁵ Sawyer, J., said: "The only prohibitory words are, that corporations of the class in question 'shall not be CREATED by special act.' The word 'create' has a clear, well-settled, and well-understood signification. It means to bring into being, to cause to exist, to produce, to make, etc. To my apprehension, it appears to be one thing to create or bring into being a corporation, and quite another to deal with it as an existing entity, a person, after it is

¹ *Colton v. Mississippi, &c. Boom Co.*, 22 Minn. 372.

² *St. Paul Fire, &c. Ins. Co. v. Allis*, 24 Minn. 75.

³ *Wallace v. Loomis*, 97 U. S.

146. Compare *Jones v. Habersham*, 107 U. S. 175, 188; *Hazlett v. Butler*, 84 Ind. 230.

⁴ *Infra*, §§ 399, 407.

⁵ 6 Sawyer, 157, 186.

created, by regulating its intercourse, relations, and acts as to other existing persons, natural and artificial. . . . The creation of the being with capacity to receive grants is one thing; the granting of other privileges and immunities which it has the capacity to receive when created, is another."

The question under consideration is simply as to the purpose and meaning of a constitutional prohibition; it is a question of fact, and cannot be determined by abstract reasoning. The purpose of a constitutional prohibition against the creation of corporations by special law is evidently to render the formation of corporations convenient and speedy, to secure uniformity in the law and equality of rights, and also to prevent the legislature from corruptly or improvidently granting special franchises to particular individuals at the expense of the community in general. A prohibition from creating corporations by special act, undoubtedly, does not in terms prohibit the legislature from passing a special law altering the charter of an existing corporation. But it is plain that a constitutional provision cannot be avoided and practically annulled by a subterfuge. A special law altering the charter of an existing corporation, and practically changing it, must therefore be deemed in violation of a constitutional prohibition against the creation of corporations by special act. If this were not so, organizations formed under the general laws might be treated merely as the rough material out of which corporations might afterwards be fashioned at pleasure, under special acts of the legislature, and the constitutional prohibition would become an empty form.¹ However, a special act of the legislature regulating an existing corporation, or granting to it new privileges, without altering its character or affecting the charter contract, would not be in violation of the letter nor of the spirit of a constitutional prohibition of this description.²

¹ See *Ex parte Pritz*, 9 Iowa, 30; *San Francisco v. Spring Valley*, 48 Cal. 493, 515; *overruling California State Tel. Co. v. Alta Tel. Co.*, 22 Cal. 398. Compare *Southern Pacific R. R. Co. v. Orton*, 6 Sawy. 157, 186.

² *Southern Pacific R. R. Co. v. Orton*, 6 Sawy. 157.

Accordingly, it was held by the Court of Appeals of New York that a law authorizing a certain insurance company to deposit with the superintendent of the insurance department a fund for the security of a certain class of policyholders was valid, notwithstanding a prohibition against the creation of corporations by special act; it was nothing more than a law regulating an existing corporation.¹ It is impossible to lay down a definite rule for determining what laws are within a prohibition of this description, and what not. Each case depends on its own peculiar circumstances.

Similar considerations apply in determining the effect of a constitutional provision against a "grant of corporate powers" by special act. Every grant of franchises to an incorporated association is, strictly speaking, a grant of corporate powers; for the franchises thus granted must be exercised by the grantees in a corporate capacity, and therefore enlarge their corporate powers. On the other hand, no grant of franchises to an unincorporated association constitutes a grant of corporate powers, unless the franchises are to be exercised by the grantees in a corporate capacity, that is, by the association as a body, without regard to the particular members for the time being composing it.² The purpose of a constitutional prohibition against "grants of corporate powers" by special acts is evidently similar to that of a provision against *the creation* of corporations by special acts. It means that the legislature shall not grant *the power to form a corporation* by special act, and this includes a prohibition against practically forming a new corporation by altering a corporation previously in existence. But it does not mean that the legislature shall not pass special laws regulating the affairs of corporations, or grant rights and privileges which may be exercised without a departure from their existing charters.

¹ *Atty.-Gen. v. North America Life Ins. Co.*, 82 N. Y. 172. An act changing the name of a corporation is not the grant of a private charter or special privilege. *Wells, Fargo, & Co. v. Oregon Ry., &c. Co.*, 8 Sawy. 600.

² Compare *State v. Stormont*, 24 Kans. 686; *Gilmore v. Norton*, 10 Kans. 504; *Ex parte Frazer*, 54 Cal. 94; *San Francisco v. Spring Valley W. W. Co.*, 48 Cal. 493, 515.

§ 13. **Prohibitions against Special and Local Laws.**—Whether an act of incorporation be a special or local act, or a general law within the meaning of a constitutional prohibition against special legislation, depends in part upon the purposes which the act is intended to accomplish. A law is not necessarily within the prohibition because its application is to a limited class, or to portions only of the State, provided there be no discrimination in favor of any part of the community, and the act be general in its application so far as the circumstances of the case permit. Thus, a law regulating a certain class of corporations would be general, although corporations of that class could carry on their business only in a particular place in the State.¹ In *Re New York Elevated R. R. Co.*,² it was held that a law applicable to existing elevated railroad companies was not a prohibited private or local law, although there was but one elevated railroad company in existence at the passage of the act.

Under a constitution providing that every act of the legislature shall embrace but one subject, which shall be described in the title, an act incorporating a company and providing various regulations for its government is valid, although entitled merely as an act to incorporate the company.³

§ 14. In some of the States, it has been provided by constitution that the legislature shall pass no act of incorporation unless with the consent of at least two thirds of each house of the legislature. Under a provision of this description, the Supreme Court of Michigan held that a general incorporation law was unconstitutional, although passed with the assent of two thirds of each house, because it was the intention of the framers of the Constitution that the legislature should remain directly responsible to the people for each and every act of incorporation.⁴ This view, however,

¹ Atty.-Gen. v. McArthur, 38 Mich. 204.

² *Re New York Elevated R. R. Co.*, 70 N. Y. 327; s. c. 3 Abb. N. C. 434; 9 Hun, 303.

³ Montgomery Mutual, &c. Ass. v. Robinson, 69 Ala. 413.

⁴ *Green v. Graves*, 1 Douglas (Mich.), 351; *Southworth v. Palmyra, &c. R. R. Co.*, 2 Mich. 287; *contra*, *Falconer v. Campbell*, 2 McLean, 195. In *Green v. Graves*, the Supreme Court of Michigan concurred in the opinion expressed by

seems not to be based upon sound reasoning, and a different conclusion was reached in New York in the construction of a similar constitutional prohibition.¹

The legislature of a State cannot incorporate an association formed for a purpose prohibited by the Constitution of the United States. Thus, it has been held that a grant of corporate franchises by a State to an association formed for the purpose of aiding the rebellion was in violation of the Constitution, and therefore invalid.²

§ 15. Delegation of the Power to charter Corporations. — Power to grant charters of incorporation may be conferred by Parliament upon any person, since Parliament is not restrained by constitutional limitations. It is held also that the King alone can license another to grant corporate franchises, the grant in such case being considered the King's own act, upon the principle that *qui facit per alium facit per se*.³

In the United States, other considerations must be borne in mind. "One of the settled maxims of constitutional law is, that the power conferred upon the legislature to make laws cannot be delegated by that department to any other body or authority. Where the sovereign power of the State has located the authority, there it must remain."⁴ The principle that *delegata potestas non potest delegari* applies in all cases where the special fitness of the trustee or agent exercising the power is material, or where a discretion must be used. It seems, therefore, that a general power to confer corporate franchises cannot be delegated by the legislature to any other agent.⁵

McLean, J., in *Falconer v. Campbell*, that the legislature might charter any number of corporations by a single act.

¹ *Thomas v. Dakin*, 22 Wend. 9, 76, 111, *per* Nelson, C. J., and Cowen, J.; *Warner v. Beers*, 23 Wend. 103, 125. As to the construction of this provision of the Constitution of New York, see *De Bow v. People*, 1 Denio, 9; *Purdy v. People*, 4 Hill, 384; 2 Hill, 31, over-

ruling *People v. Morris*, 13 Wend. 325.

² *Trustees of Endowment Fund v. Satchwell*, 71 N. C. 111; *Chicora Co. v. Crews*, 6 Rich. (S. C.) 243.

³ Bl. Com. 474; Kyd on Corp. 50; Angell & Ames on Corp. 74.

⁴ *Cooley's Constitutional Limitations*, 116.

⁵ Compare *Franklin Bridge Co. v. Wood*, 14 Ga. 80, 83; *Bank of Chenango v. Brown*, 26 N. Y. 467.

However, where the legislature has enacted that corporations may be formed upon compliance with certain conditions, it is no objection that ministerial duties, such as the issuing of a certificate or charter, must be performed by some officer before the incorporation takes effect.¹ Such officer may be required first to exercise his judgment whether the corporation proposed to be formed falls within the provisions of the general law or not; but he has no right to refuse an application made in compliance with the provisions of the statute;² and if he should refuse to act when called upon in a proper case, a writ of mandamus may be obtained to compel him to perform his duty.³

§ 16. In the case of the New York Elevated Railroad Company, the Court of Appeals of New York held that an act for the incorporation of elevated and underground railroads was not unconstitutional because it conferred on certain commissioners the power to determine the necessity of such railways, to fix the routes upon which they should be located, and to prescribe the plans for their construction. Earl, J., delivering the opinion, said: "The act rests upon the legislative will, and in no way depends for its vitality upon the action of the commissioners. Corporations organized under the act derive their franchises from the legislature, and in no proper sense from the commissioners. The commissioners perform

The Regents of the University of New York are invested by law with a discretionary power to establish colleges according to certain prescribed rules. This law has been frequently acted upon, and has been recognized as valid. *Per* Cowen, J., in *Thomas v. Dakin*, 22 Wend. 110. Neither Columbia College, nor any of the colleges incorporated by the regents, have authority to charter other colleges. *Medical Institution v. Patterson*, 1 Denio, 61.

¹ *Franklin Bridge Co. v. Wood*, 14 Ga. 80, 84; *Greenville, &c. R. R. Co. v. Johnson*, 8 Baxter, 332.

² *Keyser v. Trustees of Bremen*,

16 Mo. 88; *In re Medical College*, 3 Whart. 445, 456; *In re Deveaux*, 54 Ga. 673. The provision of the New York statute requiring the approval of a justice of the Supreme Court before filing certain certificates of incorporation, does not make such approval, when obtained, conclusive, but the Secretary of State may still refuse to file the certificate if it is not in accordance with the requirements of the law. *People v. Nelson*, 46 N. Y. 477; 11 Abb. Pr. n. s. 106; 10 Id. 200.

³ *In re Spring Valley W. W. Co.*, 17 Cal. 136; *Franklin Bridge Co. v. Wood*, 14 Ga. 80, 84.

no legislative acts ; they enact no laws ; they simply perform administrative acts in carrying the law into effect and applying it.”¹ The powers of the commissioners in this case were in the nature of police powers ; the right of the legislature to confer these powers was based upon the same ground as the right to invest overseers and other executive officers with discretionary powers in guarding public interests and watching over the safety and welfare of the State.

§ 17. The maxim that the legislature cannot delegate its authority must not be understood as prohibiting the formation of municipal corporations with powers of local government. Usage in this country and in England, from time immemorial, has established this practice so firmly, that the constitutional maxim must be taken as impliedly qualified to this extent.² However, the powers delegated to municipalities under this custom relate to matters of local government only, and do not include the power to grant charters of incorporation to private companies. This power could certainly not be exercised in the absence of an express grant of authority.³

Congress has authority, under Article IV. of the Constitution, to make all needful rules and regulations respecting the Territories. This clause authorizes Congress to organize Territorial governments having full legislative powers, including the power to charter corporations.⁴

§ 18. **What constitutes a Grant of Corporate Franchises.** — No certain forms are necessary to a grant of corporate franchises, unless required by the Constitution. Any expression showing an intention on the part of the legislature to confer the right to exercise corporate powers is sufficient, and this intention may be deduced from the whole of the legislative act. The use of the word “incorporate,” or a similar expression, is not necessary. Thus, the statute chartering the Ar-

¹ *Re New York Elevated R. R. Co.*, 70 N. Y. 327, 343.

² *Cooley's Constitutional Limitations*, 118.

³ *Kyd on Corp.* 46, 47; *Grant on Corp.* 12; *Cuddon v. Eastwick*, 1 Salk. 192.

⁴ *Vincennes University v. Indiana*, 14 How. 270; *Williams v. Bank of Michigan*, 7 Wend. 539. By act of Congress, Territorial governments can charter corporations only through general laws. *R. S. U. S.* (1874), § 1889.

kansas State Bank contained no express words incorporating any particular persons, but provided that the management of the bank should be under a given number of directors, to be chosen by the legislature, and conferred the usual banking powers upon them. This was held to incorporate the directors, inasmuch as they could exercise the powers conferred upon them only in a corporate capacity.¹

The real character of an association does not depend upon the name by which it is called. In *Thomas v. Dakin*,² Cowen, J., said: "It has been impossible for me to see the force of the argument, that, because the legislature have constantly avoided to call these associations, or any of their machinery, *a corporation*, therefore we cannot adjudge them to be so. If they have the attributes of corporations, if they are so in the nature of things, we can no more refuse to regard them as such than we could refuse to acknowledge John or George to be natural persons, because the legislature may, in making provisions for their benefit, have been pleased to designate them as belonging to some other species."

For this reason it was decided by the Supreme Courts of the United States and of the State of Massachusetts that a company formed in England under acts of Parliament investing it with corporate franchises was a corporation within the meaning of a law enacted in Massachusetts, although the acts of Parliament expressly provided that they should not be construed to incorporate the company. The provision in the acts of Parliament declaring that they should not be construed to incorporate the company was contradictory to the other provisions, which actually did invest the company with

¹ *Mahoney v. Bank of Arkansas*, 4 Ark. 620. See also *Western Union Tel. Co. v. Union Pacific Ry. Co.*, 1 McCrary, 581; *Commonwealth v. West Chester R. R. Co.*, 3 Grant's Cas. 200; *Delaware Division Canal Co. v. Commonwealth*, 50 Pa. St. 399; *Dean v. Davis*, 51 Cal. 406; *Dunn v. University*, 9 Or. 357; *Walsh v. Trustees of New*

York, &c. Bridge, 96 N. Y. 427; *Kyd on Corp.* 62; *Conservators of River Tone v. Ash*, 10 B. & C. 349; *Denton v. Jackson*, 2 Johns. Ch. 320; *North Hempstead v. Hempstead*, 2 Wend. 109; *Commissioners of Bath v. Boyd*, 1 Ired. L. 194; *Bow v. Allentown*, 34 N. H. 351.

² *Thomas v. Dakin*, 22 Wend. 9, 103.

the attributes of a corporation. The effect of this provision might perhaps be to alter the meaning of the word "incorporate" in English law, but it did not change the real nature of the company. It certainly could not impose a rule for the construction of statutes passed by a foreign state.¹

§ 19. The intention of the legislature to confer corporate franchises is essential to an act of incorporation, and no presumption should be allowed in favor of the grant. Thus, where a statute provided that, if any association of citizens should thereafter be formed for the purpose of banking, every member thereof should be individually and personally liable for the debts of the association, it was held that this did not constitute an association formed under the act a corporation; and that the only effect of the act was to guard against associations, the members of which attempted to protect themselves against personal liability by expressly stipulating against it.² So, a grant of the privilege to raise money by lottery was held not to incorporate the grantees for that purpose.³

§ 20. **Ratification by the Legislature of a Claim of Corporate Franchises.**—The existence of a corporation formed without legislative authority may be legalized by the subsequent assent of the legislature. For this purpose it is not necessary that an act be passed investing the association with corporate franchises by express terms; but it is sufficient if the legislature by statute recognizes, and thereby ratifies, the franchises which have been claimed.⁴ Thus a statute annexing other territory "to the town of A," by implication makes it a town if it was not a town before.⁵ A statute

¹ *Liverpool Ins. Co. v. Massachusetts*, 10 Wall. 566; 100 Mass. 531; see also *People v. Assessors of Watertown*, 1 Hill, 620; *Thomas v. Dakin*, 22 Wend. 9, 69; *Warner v. Beers*, 23 Wend. 103.

² *Myers v. Irwin*, 2 S. & R. 368.

³ *Gregory v. Shelby County*, 2 Met. (Ky.) 589. See also *Proprietors of Southold, &c. v. Horton*, 6

Hill, 501; *Shelton v. Banks*, 10 Gray, 401.

⁴ *Kanawha Coal Co. v. Kanawha, &c. Coal Co.*, 7 Blatchf. 391; *People v. Farnham*, 35 Ill. 562; *Williams v. Union Bank*, 2 Humph. 339; *Society for the Propagation of the Gospel v. Pawlet*, 4 Pet. 480; *McDougald v. Bellamy*, 18 Ga. 412; *People v. Perrin*, 56 Cal. 345.

⁵ *Bow v. Allentown*, 34 N. H. 351.

amending the charter of a railroad company legalizes the subsequent existence of the company, though it had originally been formed in violation of the law.¹

However, no greater effect can be attributed to a statute than appears to have been intended by the legislature enacting it. A mere recital in an act of the existence of a company claiming the right to exercise corporate franchises cannot be construed to legalize the claim, unless the context shows that this was intended.² It must appear that the legislature intended that the association should have the right of acting in a corporate capacity.

Such subsequent ratification may not only legalize the existence of a corporation formed without authority of law, and authorize the association to act in a corporate capacity thereafter, but it may also cure the illegality of corporate acts performed before the act of ratification was passed, and render such acts as valid and binding as if authority to perform them had been previously granted by the legislature.³

§ 21. **Acceptance of the Charter.**—A charter of incorporation is not merely an enabling law passed by the legislature; it has been held that a charter or act of incorporation is intended to operate as a grant of franchises in the same manner as a grant from a private individual. For these reasons, it follows that a grant of corporate franchises does not become effective and binding until accepted by the grantees. No rights can be claimed under a charter until after it has been accepted by the grantees.⁴ If the grantees of a charter refuse to accept it, and still undertake to exercise corporate powers, a proceeding of *quo warranto* will lie.⁵ The offer of a charter of incorporation by the State remains open for a

¹ *McAuley v. Columbus, &c. R. Co.*, 83 Ill. 348.

² *Green v. Seymour*, 3 Sandf. Ch. 285; *Thornton v. Marginal Freight Co.*, 123 Mass. 32.

³ *St. Louis R. R. Co. v. Northwestern St. Louis Ry. Co.*, 2 Mo. App. 69; *Baschor v. Dressell*, 34 Md.

503; *Illinois Grand Trunk R. R. Co. v. Cook*, 29 Ill. 237; *Goodrich v. Reynolds*, 31 Ill. 490. See *infra*, § 631.

⁴ *Green v. Seymour*, 3 Sandf. Ch. 285, 291; compare *Lyons v. Orange, &c. R. R. Co.*, 32 Md. 18, 29.

⁵ *Thompson v. New York, &c. R. R. Co.*, 3 Sandf. Ch. 626.

reasonable time only, and if not accepted within a reasonable time its legal effect expires.¹

After a charter has been accepted by the grantees, it is in many instances treated as embodying an irrevocable grant or contract under the protection of the Constitution of the United States.²

§ 22. A charter must be accepted as it is offered by the legislature, and no terms can be imposed.³ The rule was stated by Lord Tenterden as follows: "A charter must be accepted or rejected *in toto*, unless there should appear an intention on the part of the crown that the body to whom the charter was given should have the liberty and power to accept in part and reject in part."⁴

Upon the same principle, a charter can be accepted only by those to whom it is offered. If it appears to be the intention of the legislature that all the grantees shall accept, a part only of the grantees can acquire no rights by accepting. Thus, where a charter was granted to the mayor, aldermen, and common-councilmen, it was held that the mayor and aldermen alone could not accept the charter.⁵

§ 23. **What is a sufficient Acceptance.** — No particular form of acceptance is necessary; but any act unequivocally showing an intention to accept the charter is sufficient.⁶ Thus, if the grantees of a charter proceed to form a corporation, and exercise corporate powers, that will in general be sufficient; for the assumption of corporate powers would be unauthorized if there were no intention to accept the franchises granted. Upon the same principle, it has been held that corporate action under an amendment to a charter is presumptive evidence that the amendment was accepted.⁷ If a

¹ *State v. Bull*, 16 Conn. 179, 191.

² *Infra*, § 1025.

³ *Lyons v. Orange, &c. R. R. Co.*, 32 Md. 18, 29; *Rex v. Amery*, 1 T. R. 589.

⁴ *Rex v. Westwood*, 2 Dow & Cl. 21; s. c. 7 Bing. 1, 90.

⁵ *Rex v. Amery*, 1 T. R. 589.

⁶ *Bank of United States v. Dandridge*, 12 Wheat. 64, 71; *Covington v. Covington, &c. Bridge Co.*, 10 Bush, 69; *Smead v. Indianapolis, &c. R. R. Co.*, 11 Ind. 104.

⁷ *Bank of United States v. Dandridge*, 12 Wheat. 64, 71; *Penobscot Boom Co. v. Lamson*, 16 Me. 224; *School District v. Gibbs*, 2 Cush.

particular charter is granted after having been applied for, acceptance may be presumed from such previous application.¹ It would seem that no acceptance would be required in such case, since the consent of the grantees was given in advance.

§ 24. **The Necessity of an Agreement between the Corporators.**—The acceptance of the franchises conferred by a charter of incorporation is not alone sufficient to constitute the grantees of the charter a corporation. The formation of a private corporation involves the creation of a contractual relation between the individuals composing it. The agreement out of which this contractual relation arises may in many cases be implied, but it is in all cases essential to the existence of a private corporation or joint-stock company.²

It is therefore not strictly correct to say that a private corporation is "created" by an act of the legislature. It is impossible in the nature of things to form a private corporation without the consent of the corporators, and the legislature has not the power to create that consent.³ Nor does the legislature intend, by granting a charter, to constitute the grantees a corporation without their concurrence. The object of a charter is merely to confer upon the grantees the right or franchise of forming a corporation, and of acting in

39; *Middlesex Husbandmen, &c. v. Davis*, 3 Metc. (Mass.) 133, 137; *Ameriscoggin Bridge Co. v. Bragg*, 11 N. H. 102; *Wetumpka & C. R.R. Co. v. Bingham*, 5 Ala. 657; *Palfrey v. Paulding*, 7 La. Ann. 363; *Bangor, O. & M. R. R. Co. v. Smith*, 47 Me. 34; *Sampson v. Bowdoinham Mill Co.*, 36 Me. 78, 81; *Bank of Manchester v. Allen*, 11 Vt. 302, 307; *Bank of United States v. Lyman*, 20 Vt. 666; s. c. 1 Blatchf. 297; *McKay v. Beard*, 20 S. Car. 156. Compare *Lyons v. Orange, &c. R. R. Co.*, 32 Md. 18.

¹ *Atlanta v. Gate City Gaslight Co.*, 71 Ga. 106, 117; *Middlesex*

Husbandmen, etc. v. Davis, 3 Metc. (Mass.) 138; *Smead v. Indianapolis, &c. R. R. Co.*, 11 Ind. 104; *Newton v. Carbery*, 5 Cranch C. C. 632; *Perkins v. Sanders*, 56 Miss. 733.

² The character of this contractual relation between the shareholders of a corporation and the agreement out of which it arises will be considered in detail hereafter. See Chapter II., beginning with § 43.

³ *Lauman v. Lebanon Valley R. R. Co.*, 30 Pa. St. 46; *Richmond Factory Ass. v. Clarke*, 61 Me. 358; *Union Hotel Co. v. Hersee*, 15 Hun, 371; *Gardner v. Hamilton Mut. Ins. Co.*, 33 N. Y. 421. *Infra*, § 716.

a corporate capacity, or, in other words, to legalize the subsequent acts of the corporators.¹

These principles have no application to public or municipal corporations. Municipalities are not voluntary associations; they are political subdivisions created by the legislature in the exercise of its powers of civil government, for the convenient administration of the affairs of the community. No agreement or consent of the inhabitants of a district is necessary in order to constitute it a township, or county, and its government remains entirely subject to legislative control.²

§ 25. *How this Agreement may be entered into.*—The agreement by which a private corporation is created may be entered into in various ways. No particular form is required unless expressly prescribed by statute. Ordinarily a simple acceptance of the charter is sufficient to indicate an agreement on the part of the grantees to form a corporation, according to its provisions; under the general incorporation laws, a subscription for shares is ordinarily all that is required.³

While no person can be made a member of a private corporation without his consent, the necessary consent may often be implied. Thus, the majority of an unincorporated association, whose purpose is the formation of a corporation, are impliedly authorized to accept a grant of corporate franchises, and form a corporation under it, in the name of all the associates.⁴ So it has been held that a majority of shareholders in an existing corporation may, in some instances,

¹ "That a man may refuse a grant, whether from the government or an individual, seems a principle too clear to require the support of authorities." *Per* Parker, C. J., in *Ellis v. Marshall*, 2 Mass. 269, 277. See also *Dartmouth College v. Woodward*, 4 Wheat. 518, 683, 684; *Beatty v. Knowler*, 4 Pet. 152, 167; *Grant on Corporations*, 18. With regard to the legislative powers which the States may exercise over private

corporations, see *infra*, Chapter XV., beginning with § 1024.

² 1 *Dillon on Municipal Corporations*, § 29 *et seq.*; *Dartmouth College v. Woodward*, 4 Wheat. 518, 668, 669; *supra*, § 3; *infra*, § 1026.

³ *Infra*, §§ 43–55.

⁴ *St. Paul Division v. Brown*, 11 Minn. 356, 360; and compare *Shortz v. Unangst*, 3 W. & S. 45, 52, 53; *Commonwealth v. Cullen*, 13 Pa. St. 133. Compare *infra*, §§ 47–50.

adopt an amendment to the charter under which the company was formed.¹

It is to be observed, also, that after a charter has been accepted by the majority of an association, or if it was granted in pursuance of an application publicly made by the majority on behalf of the whole company, a presumption often arises that all acquiesce who do not express their dissent.² If the majority have acted without authority under these circumstances, the dissenting members should, without delay, make known their dissent, and restrain every attempt to act under the charter.³

§ 26. **Conditions Precedent to Incorporation under a Special Charter.** — Whether the grantees of a charter shall be entitled to form a corporation and exercise corporate powers, after a simple acceptance of their charter, or only after the performance of certain conditions precedent, necessarily depends upon the terms of the grant.⁴ If not provided to the contrary, the incorporation will take effect as soon as the charter has been accepted; and it has been held that, even though a particular mode of acceptance be directed, as by filing a certificate, a failure to comply is not decisive. "It is the fact of acceptance that binds the company, and the certificate is merely evidence of the fact."⁵

Accordingly, it has been held that, under a charter providing that the grantees, and such other persons as may be associated with them, "shall be, and they are hereby, incorporated," the grantees are authorized to form a corporation, and exercise corporate powers, without having taken associates or appointed officers.⁶ So, a grant of a charter to one,

¹ See *infra*, § 407.

² *Infra*, § 603.

³ *Ferris v. Strong*, 3 Edw. Ch. 127; *Owen v. Purdy*, 12 Ohio St. 73, 79. *Infra*, § 610.

⁴ See *Fire Department v. Kip*, 10 Wend. 267.

⁵ *Cincinnati, H. & D. R. R. Co. v. Cole*, 29 Ohio St. 126.

⁶ *Frost v. Frostburg Coal Co.*,

24 How. 278; *Hughes v. Parker*, 20 N. H. 58; *Stoops v. Greensburgh Plank Road Co.*, 10 Ind. 47; *Judah v. American Live Stock Ins. Co.*, 4 Ind. 333; *Rathbone v. Tioga Nav. Co.*, 2 W. & S. 74, 79; *Vermont Central R. R. Co. v. Claves*, 21 Vt. 30. See *Minor v. Mechanics' Bank*, 1 Pet. 46, 63; *Perkins v. Sanders*, 56 Miss. 733, 739; *State v. Sibley*, 25 Minn. 387.

with liberty to take associates, will invest the sole grantee with all the corporate franchises, if this appear to be the intention of the legislature; and even if it were the duty of the grantee to take associates, this would only be a condition to be performed before the corporation would be authorized to begin to carry on its business.¹

However, where a charter declared that the grantees, and such other persons as should afterwards become stockholders, "are hereby constituted a body politic," and by another provision of the act a discretion was vested in certain commissioners to distribute the whole number of shares into which the company's capital was divided among the subscribers, in case more than the amount limited had been applied for, the distribution of shares was held to be a condition precedent to the formation of a corporation. For, in this case, the grantees of the franchises and the members of the company could not be ascertained until after the shares had been apportioned.²

§ 27. **Incorporation under General Laws. — Conditions Precedent.** — General incorporation laws are now in force in nearly every State in the Union.³ By virtue of these laws the right to form a corporation and to exercise corporate powers is extended to all persons who comply with certain prescribed conditions; an association which has satisfied the statutory requirements becomes invested with corporate franchises as fully as if it had been incorporated under a special charter.

It is frequently provided that the parties wishing to form a corporation under a general law shall file articles detailing the purposes of their association with the Secretary of State, or some other officer whose duty it is then to issue a certifi-

¹ *Penobscot Boom Co. v. Lamson*, 16 Me. 224; *Day v. Stetson*, 8 Greenl. (Me.) 365, 371; *Brouwer v. Appleby*, 1 Sandf. 158.

v. Hart, 31 Md. 59. See *infra*, § 66.

² *Crocker v. Crane*, 21 Wend. 211; *Walker v. Devereaux*, 4 Paige, 229; *Franklin Fire Insurance Co.*

³ The formation of corporations under general laws will be considered in detail in the following chapter, in treating of the contract of membership.

cate or charter. This officer may be required to decide in the first place whether the proposed corporation be within the purview of the general law or not; but the ultimate decision rests always with the courts.¹

A substantial compliance with all the terms of a general incorporation law is a prerequisite of the right of forming a corporation under it. Thus, where it is provided that a certificate or articles of association, setting forth the purposes of the corporation about to be formed, the amount of its capital, and other details, shall be filed with some public officer, a performance of this requirement is essential; and until it has been performed, the association will have no right whatever to assume corporate franchises.² So, under some statutes, a license or certificate must be issued by a specified public officer before the corporation can be legally formed.³

The articles of incorporation must contain everything in substance that the laws under which the corporation is organized prescribe. Thus, if it is prescribed that the number or the names of the first directors of the corporation shall be set forth, a compliance with this provision is essential.⁴ A provision, requiring the articles of incorporation to set forth that a majority of the members of the association voted at the first election of directors, is obligatory; and if the articles omit the required statement, proof cannot be admitted to show

¹ See *supra*, § 15. Compare *Litchfield Bank v. Church*, 29 Conn. 137, 148; *Society for Visitation of the Sick v. Commonwealth*, 52 Pa. St. 125.

² *Stowe v. Flagg*, 72 Ill. 397; *Bigelow v. Gregory*, 73 Ill. 197; *Harris v. McGregor*, 29 Cal. 124; *Abbott v. Omaha Smelting Co.*, 4 Neb. 416; *Doyle v. Mizner*, 42 Mich. 332; *Utley v. Union Tool Co.*, 11 Gray, 139; *McIntire v. McLain Ditching Ass'n*, 40 Ind. 104; *Indianapolis Furnace, &c. Co. v. Herkimer*, 46 Ind. 142; *Unity Ins. Co.*

v. Cram, 43 N. H. 636; *Childs v. Smith*, 55 Barb. 45; s. c. 46 N. Y. 34; *Harrod v. Hamer*, 32 Wis. 162; *In re Deveaux*, 54 Ga. 673. Compare *infra*, §§ 29, 41. As to what is a sufficient signature of the articles of association, see *State v. Beck*, 81 Ind. 500.

³ *Richmond Factory Ass. v. Clarke*, 61 Me. 351; *Stowe v. Flagg*, 72 Ill. 397; *Field v. Cooks*, 16 La. Ann. 153.

⁴ *Reed v. Richmond Street R. R. Co.*, 50 Ind. 342.

that a majority were in fact present and voted.¹ Under a law requiring a certificate to be filed showing the manner of carrying on the business of the association, it is not sufficient to state merely that "the manner of carrying on the business shall be such as the association may from time to time prescribe by rules, regulations, and by-laws."²

§ 28. Any other conditions precedent imposed by the express terms of the law must of course be complied with before the corporators can lawfully form a corporation.³ It has often been held, for like reasons, that a person cannot become a member of an existing corporation, and as such entitled to participate in the corporate franchises, through a transfer of shares from a prior member, except by complying with the formalities of a transfer prescribed by law.⁴

Upon the same general principle, it follows that a corporation cannot lawfully act in a foreign State, and carry on business there, until all conditions precedent prescribed by the laws of such State have been performed.⁵

§ 29. **What are Conditions Precedent to Legal Incorporation.** — There is a plain distinction between conditions which must be complied with before the grantees of a charter are entitled to form a corporate association, and conditions the performance of which is merely a prerequisite of the right to carry on business after the corporation has been formed. A failure to comply with a condition of the latter kind does not invalidate the contract of membership entered into by the shareholder, or affect the rightful existence of the corporation.⁶

Thus, if the capital of a corporation is fixed by its charter at a certain sum, this would *prima facie* indicate that the company would have no right to begin to carry on business until the whole amount of capital prescribed by the char-

¹ *People v. Selfridge*, 52 Cal. Mich. 332; *Unity Ins. Co. v. Cram*, 331. 43 N. H. 636.

² *State v. Central Ohio Relief Ass.*, 29 Ohio St. 399.

⁴ *Infra*, §§ 169-171.

⁵ See *infra*, §§ 641-645, 939.

³ *Atty.-Gen. v. Hanchett*, 42 Mich. 436; *Doyle v. Mizner*, 42

⁶ See *Harrod v. Hamer*, 32 Wis. 162.

ter has been obtained; the subscription of the whole capital would be a condition precedent to the right of carrying on the corporate business, and to the liability of the shareholders to contribute their respective shares of capital.¹ To begin business and incur debts before the whole capital has been subscribed would be an unauthorized exercise of corporate power, and a violation of the contract of every individual shareholder.² But it does not follow that the subscribers would be unable to form an incorporated association until the whole amount of the shares had been taken. In many instances, the subscribers of a portion of the stock would be authorized to form a corporation among themselves, and would have full authority to do all corporate acts necessary to a complete organization of the company, though they would have no right to begin to carry on its regular business.³

§ 30. The proper authentication and recording of the articles of association of a corporation have for obvious reasons been held to be conditions precedent to the right of forming a corporation under the general incorporation laws;⁴ but a compliance with a provision requiring a copy of the articles so recorded to be filed with a specified public officer, has ordinarily not been considered a condition precedent to the incorporation of the company.⁵ It would merely be a condition precedent to the right of carrying on business.⁶

In *People v. Chambers*,⁷ it was held that a provision in an act for the incorporation of railroad companies, requiring the payment in cash of ten per cent of the amount of the capital subscribed, imposed a condition precedent to the right of the

¹ See *infra*, §§ 137, 408. This rule, of course, has no application where the charter expressly authorizes the company to begin the prosecution of its enterprise before the capital has been fully subscribed. See *infra*, § 140.

² *Infra*, §§ 717-720.

³ *Central Turnpike Co. v. Valentine*, 10 Pick. 142; *City Hotel v. Dickinson*, 6 Gray, 586, 593, 594; *Perkins v. Sanders*, 56 Miss. 733; and see *infra*, § 140.

⁴ *Supra*, § 27.

⁵ *Mokelumne Hill Mining Co. v. Woodbury*, 14 Cal. 424; *Humphreys v. Mooney*, 5 Col. 283; *Hyde v. Doe*, 4 Sawy. 133; *Cross v. Pinckneyville Mill Co.*, 17 Ill. 54. Compare *Indianapolis Furnace, &c. Co. v. Herkimer*, 46 Ind. 142.

⁶ *Hurt v. Salisbury*, 55 Mo. 310.

⁷ *People v. Chambers*, 42 Cal. 201. See *infra*, § 71.

subscribers to form a corporation. On the other hand, it was decided in Maryland that a clause in a bank charter, reciting that the company should be entitled to the benefits and privileges of the act when a certain percentage of the capital of the corporation should be paid in, and the fact certified in the manner prescribed, and not before, did not impose a condition precedent to the incorporation of the company.¹ This was merely a condition precedent to the right of carrying on business. So it has been held that a failure to comply with a provision requiring a fee of one hundred dollars to be paid to the State before the corporation "shall be organized," did not prevent the legal incorporation of a company.²

Under a charter purporting to incorporate the grantees immediately, but subject to a proviso, that, "when one hundred thousand dollars shall have been subscribed and one dollar per share shall have been paid in, the said company may organize and proceed to work," it was held that the provision did not impose a condition precedent, and the grantees were entitled to form a corporation immediately.³

§ 31. **Effect of Violation of Charter after Incorporation.** — If the charter of a corporation prescribes a duty to be performed by the company after it has been incorporated, a failure to perform the prescribed duty will not of itself render the continued existence of the association unauthorized.⁴ Nor is the legal existence of a corporation terminated by the fact that it has violated its charter, as by carrying on business before conditions precedent imposed by the charter have been complied with.⁵ Only the State, proceeding by *quo*

¹ *Hammond v. Straus*, 53 Md. 1.

² *Hughesdale Manuf. Co. v. Vanner*, 12 R. I. 491.

³ *Spartanburg & A. R. R. Co. v. Ezell*, 14 S. C. 281.

A provision in a charter, that the corporation "shall be deemed organized when the president shall be elected, and shall be deemed in practical operation from the time the permission and authority provided in the first section is ob-

tained," superseded a provision of the general law requiring the organization to be perfected within one year. *People v. Bowen*, 30 Barb. 24, 40, affirmed 21 N. Y. 517.

⁴ *Charles River Bridge v. Warren Bridge*, 7 Pick. 344, 371; *Lyons v. Orange, &c. R. R. Co.*, 32 Md. 18; *Boise City Canal Co. v. Pinkham*, 1 Idaho, N. S. 790.

⁵ *Harrod v. Hamer*, 32 Wis. 162, 166.

warranto, can object to the existence of an association under corporate organization, after the right to its continuance has been forfeited.¹

In *Mokelumne Hill Mining Co. v. Woodbury*,² Cope, J., said: "There is a broad and obvious distinction between such acts as are declared to be necessary steps in the process of incorporation, and such as are required of the individuals seeking to become incorporated, but which are not made prerequisites to the assumption of corporate powers. In respect to the former any material omission will be fatal to the existence of the corporation, and may be taken advantage of collaterally in any form in which the fact of incorporation can properly be called in question. In respect to the latter, the corporation is responsible only to the government, and in a direct proceeding to forfeit its charter."

§ 32. **Substantial compliance with Conditions sufficient.**—Acts of incorporation should not receive a technical construction, and a substantial performance of the requirements of the law is sufficient; mere informalities or immaterial variations in matters of detail do not affect the legality of an incorporation.³

In *Eastern Plank Road Co. v. Vaughan*,⁴ it was held that a corporation was not illegally organized merely because the articles of association contained a provision which was unauthorized by the general law under which the corporation

¹ *Infra*, § 995.

² 14 Cal. 424, 426. See also *Lord v. Essex Building Ass.*, 37 Md. 320, 325-327; *First National Bank v. Davies*, 43 Iowa, 424; *State v. Real Estate Bank*, 5 Ark. 595; *Searsburgh Turnpike Co. v. Cutler*, 6 Vt. 315; *Holmes v. Gilliland*, 41 Barb. 568; *Narragansett Bank v. Atlantic Silk Co.*, 3 Metc. (Mass.) 282, 287; *Hurt v. Salisbury*, 55 Mo. 310. Compare *Utley v. Union Tool Co.*, 11 Gray, 139.

³ *In re Spring Valley W. W. Co.*, 17 Cal. 132; *People v. Stock-*

ton, &c. R. R. Co., 45 Cal. 306; *Roman Catholic Orphan Asylum v. Abrams*, 49 Cal. 455; *Eakright v. Logansport, &c. R. R. Co.*, 13 Ind. 404; *Rogers v. Danby, &c. Society*, 19 Vt. 187; *Walworth v. Brackett*, 98 Mass. 98; *People v. Cheeseman*, 7 Col. 376.

⁴ *Eastern Plank Road Co. v. Vaughan*, 14 N. Y. 546, 551; *Becket v. Uniontown Building, &c. Ass.*, 88 Pa. St. 211; *Albright v. Lafayette, &c. Ass.*, 102 Pa. St. 411. Compare *Heck v. McEwen*, 12 Lea (Tenn.), 97.

was formed. The unauthorized provision was treated as surplusage.

In Indiana it was held that, under a general law authorizing the incorporation of associations for the encouragement of agriculture, corporations might be formed in order to purchase land to be used for fairs and horse shows, and for exhibiting the speed of horses in races and distributing prizes.¹ Under a general law authorizing the organization of corporations for "the conversion and disposal of agricultural products by means of mills, elevators, markets, and stores, or otherwise," a corporation may be created "to build and maintain a flouring-mill."² The question in each case is to determine the substantial purpose of the law.³

A general act authorizing the formation of corporations for any purpose is always subject to the implied limitation that no corporation shall be formed for a purpose which would be contrary to public policy or any established rule of law.⁴

§ 33. **Shareholders are Necessary.** — It is plain that a joint-stock company or trading corporation cannot possibly exist without stockholders or members. It would be a contradiction in terms to speak of an association existing without associates composing it.

There are, however, instances in which a corporation or joint-stock company may, by the use of a fiction, be deemed in existence, although there be no members or shareholders composing it, and hence in reality no corporation or company. Thus, some of the general incorporation laws in force in the United States provide that, whenever a specified number of persons shall desire to form a corporation, they may do so by signing and filing a certificate of association, setting forth the purposes of the company, the amount of its

¹ *Mullen v. Beech Grove Driving Park Ass.*, 64 Ind. 202. N. Y. 477; 10 Abb. Pr. n. s. 200; 11 Id. 106; *State v. Monitor Fire*

² *Ginrich v. Patrons' Mill Co.*, 21 Kans. 61. Ins. Co., 42 Ohio St. 555. Compare *infra*, § 362.

³ For instances see *Wisconsin Telephone Co. v. Oshkosh*, 62 Wis. 32; *People v. Troy House Co.*, 44 Barb. 626, 632; *People v. Nelson*, 46

⁴ *Re Mutual Aid Ass.*, 15 Phila. 625; *Re Helping Hand Marriage Ass.*, Id. 644.

capital, and other particulars. Upon filing the prescribed instrument, the persons who have signed the same and their successors are declared by the statute to become a body politic or corporate, and to become invested with all the powers conferred by the act.¹ Under a statute of this description, the corporation must be deemed in existence for certain purposes from the time when the certificate of incorporation is filed, although there be no shareholders in the company. The directors named in the certificate are authorized to act in the corporate name in doing all acts which are necessary to obtain subscriptions for shares and to perfect the company's organization; and it has been held that property may be held in the corporate name for future use.² It is evident, however, that the shareholders, and not the signers of the certificate of incorporation, in reality constitute the corporation to be formed under the statute. The signers of the certificate have no authority to carry on business in the corporate name; they have no interest in the corporate estate, and no rights in its management or in the election of officers. They are at the most a quasi corporation, whose sole function is to bring into existence the corporation consisting of the real body of shareholders. The fact, that the statute expressly declares that the signers of the certificate and their successors shall be a body corporate, can make no difference. The statute does not intend that they shall be a corporation except in name. Mere names do not alter facts, and no amount of legislation can make a reality out of a fiction.

§ 34. Under some charters a board of directors or trustees is constituted a body corporate by law, while the shareholders are the parties really interested in the corporate estate. A corporation of this description differs from an ordinary corporation only in form. The shareholders are practically and in

¹ See the act of New York, of Co., 11 Kans. 412; Willamette 1848, for the incorporation of manufacturing and other corporations. 261.

See also the general laws of Kansas. ² Coyote, &c. Mining Co. v. Ruble, 8 Ore. 284, 293. Compare Hunt v. Kansas, &c. Bridge

reality the corporate association, and the directors or trustees are the agents of the association. It is only in dealing with the technical rules relating to legal procedure and the title to property, that the trustees or directors are to be regarded as themselves constituting the corporation.

Charitable corporations differ essentially from ordinary business corporations and joint-stock companies in this respect. A charitable corporation is not an association of shareholders, like a business corporation or joint-stock company; but is merely an agent or trustee for the administration of trust funds, and the beneficiaries of the trust are the donees of the charity, and not the members of the corporation.

§ 35. **Who can form a Corporation.** — Kyd said: "A corporation is usually composed of natural persons, merely in their natural capacity; but it may also be composed of persons in their political capacity of members of other corporations."¹ Thus the "mayor, citizens, and commonalty," or the "mayor, aldermen, and common-councilmen," may be incorporated.²

Any person capable of contracting may become an original shareholder in a private corporation, unless the contrary is provided by the charter or act of incorporation.³ Even women and children, and persons *non compos mentis*, may become corporators by transfer or inheritance of the shares of a prior holder. The members of an ordinary trading corporation do not occupy positions of confidence and trust toward each other, as partners do; but the interest of each shareholder, and all the rights pertaining thereto, may be assigned like personal property.⁴

If a general law purports to authorize "any number of persons not less than seven" to organize a corporation for the construction of a railroad, citizens or residents of another State or country are entitled to organize under the law.⁵

Several distinct and independent corporations may together

¹ Kyd on Corp. 32, 33, 35.

⁴ *Infra*, §§ 163, 164, 224.

² *Ibid.* 33; *Rex v. Amery*, 1 T. R. 575, 589.

⁵ *Central R. R. Co. v. Pennsylvania R. R. Co.*, 31 N. J. Eq. 475; *Humphreys v. Mooney*, 5 Col. 282.

³ *Infra*, § 66.

form one general corporate body.¹ It is a matter of common occurrence for one business corporation to hold shares in another corporation of a similar description.²

A State or municipality may become a shareholder in a private corporation; and the fact that a State is a shareholder, or even the sole shareholder, does not alter the legal *status* of the company as a private corporation.³

The right of membership in a corporation may, however, be restricted by express provision of the charter. Thus, a corporation may be limited to a certain class of people or tradesmen.⁴ So right of membership in societies and clubs is often restricted to persons of a particular class or description.

§ 36. **Corporations by Prescription.** — “Corporations by the common law” are those corporations of a political character which have existed with the universal assent of the community from time immemorial; as the King, bishops, and other church officers.⁵ A corporation is said to exist by prescription if its commencement cannot be shown, but a grant of a charter may be presumed from long-continued user of the corporate franchises.⁶

The same doctrine has been frequently asserted in the United States with regard to public corporations. “Municipal corporations are created for the public good,—are demanded by the wants of the community; and the law, after long-continued user of corporate powers, and the public acquiescence, will indulge in presumptions in favor of their legal existence.”⁷

¹ Kyd on Corp. 34.

² See *infra*, §§ 411–413. *Ex parte Fisher*, 20 S. Car. 180.

³ *Bank of United States v. Planters' Bank*, 9 Wheat. 904; *Briscoe v. Bank of Kentucky*, 11 Pet. 257; *Bank of S. Car. v. Gibbs*, 3 McCord, 377; *State Bank v. Clark*, 1 Hawks, 36; *Moore v. Schoppert*, 22 W. Va. 282; *Marshall v. Western, &c. R. R. Co.*, 92 N. Car. 322. See *supra*, § 3.

The United States held shares in the United States Bank incorporated in 1791.

⁴ Kyd on Corp. 35; *Milford v. Godfrey*, 1 Pick. 98.

As to limitations of the number of shares which may be held by any shareholder, see *O'Brien v. Cummings*, 13 Mo. App. 197.

⁵ Kyd on Corp. 40.

⁶ *Ibid.* 41.

⁷ *Jameson v. People*, 16 Ill. 257,

General reputation and a long-continued user of corporate powers have been held sufficient to establish the franchises of a municipal corporation, without first showing a loss of its charter, or that it ever had one.¹ And this may be sustained upon the ground that the general consent of the public makes a customary or common law.

But the acquiescence of the public cannot upon the same principle be held to legalize a private corporation; for the public are ordinarily not concerned in the existence of a private corporation, and acquiescence can have no weight where there is no cause for objecting.

Long-continued user of corporate franchises may undoubtedly be presumptive evidence that a charter was granted, in the United States as well as in England;² but in the United States all franchises must be derived from an act of the legislature, and it is generally possible to ascertain with certainty whether or not a corporation was chartered, by reference to the statute-books or the record of the articles of incorporation.

§ 37. **Proof of Incorporation, — when necessary.** — The necessity of proving the lawful formation and existence of a corporation, necessarily depends in every case upon the issues presented by the pleadings; the materiality of these issues is governed by the rules of substantive law.

In a suit brought by or against a corporation, the existence of the corporation *de facto* is always an essential allegation, and may therefore be put in issue;³ but *the legality* of the existence of the corporation is often not material. There are numerous instances in which it is of no legal consequence whether the corporation was formed lawfully, under a grant of authority from the legislature, or unlawfully, without the

259, *per Skinner, J.*; 1 Dillon on Mun. Corp., § 37 (17).

¹ *People v. Maynard*, 15 Mich. 463, 470; *Bow v. Allenstown*, 34 N. H. 351; *Dillingham v. Snow*, 5 Mass. 547; *New Boston v. Dunbarton*, 15 N. H. 201; *Sherwin v. Bugbee*, 16 Vt. 439; *Londonderry v.*

Andover, 28 Vt. 416; *Robie v. Sedgwick*, 35 Barb. 319, 326.

² *Greene v. Dennis*, 6 Conn. 293, 302; *All Saints' Church v. Lovett*, 1 Hall, 191; *White v. State*, 69 Ind. 273.

³ *Infra*, § 750.

proper authority.¹ In some cases, also, the existence of the corporation *de facto*, as well as *de jure*, may be presumed without any evidence, or may be proven by evidence of an admission of the opposing party.² Cases of this character should be carefully distinguished from those cases in which the lawful formation and existence of the corporation are material, as upon a proceeding of *quo warranto* brought by the State on account of an unauthorized assumption of corporate franchises. Under these circumstances, it becomes necessary to establish, first, a grant of franchises by the State; secondly, acceptance of the franchises by the grantees; and thirdly, the formation of a corporate association by the grantees.

§ 38. **Proof of Charter.** — **Public and Private Acts.** — General incorporation laws are now in force in every State in the Union. They are public statutes, and must therefore be judicially recognized, without the production of evidence to prove them, by every court within the State enacting them. The same rule applies to special charters conferring corporate franchises, where they are granted by public statute; but a charter granted by a private act must be proven.

No certain rule can be laid down, showing which laws are public and which are private. Charters of incorporation granted to a plank-road company,³ a railroad company,⁴ and an academy,⁵ were held to be private acts, which could not be judicially noticed. On the other hand, it was held that the charter of a bank was a public law, which required no proof.⁶

The line of distinction has been sometimes drawn between those corporations which were created to subserve a public

¹ *Infra*, § 724 *et seq.*

² *Infra*, § 754.

³ *City Council of Montgomery v. Montgomery, &c. Plank R. Co.*, 31 Ala. 76.

⁴ *Ohio, &c. R. R. Co. v. Ridge*, 5 Blackf. 78.

⁵ *Bailey v. Trustees of Lincoln Academy*, 12 Mo. 174.

⁶ *Stribbling v. Bank of the Valley*, 5 Rand. 132; *Hays v. Northwestern Bank*, 9 Gratt. 127; *Williams v. Union Bank*, 2 Humph. 339; *Towson v. Havre-de-Grace Bank*, 6 H. & J. 47.

purpose, and those which were chartered for the benefit of the corporators only. It has been held, that in the former case the courts will take judicial notice of the charter, but not in the latter case.¹ The distinction itself has, however, been strongly condemned, and in the opinion of Carr, J., it is "founded much more in technical reasoning than in common sense."²

Charters of incorporation often provide expressly that they shall be considered public acts. Under these circumstances no question as to the public or private character of the acts can arise. If the grant of a charter is referred to, or recognized in a public law, the courts will thereafter take judicial notice of its existence.³ And an act conferring new franchises upon a corporation already formed, under a public law, will be regarded as a public law also.⁴

§ 39. **Foreign Charters.**—A charter of incorporation granted by a foreign country or a sister State must be proven like any other foreign law.⁵

The different States of the Union have provided convenient methods of proving the laws and enactments of the other States; as by authenticated copy, or by the printed volumes purporting to be issued by authority. But this does not exclude the common law proof of a charter by a witness testifying to the accuracy of a copy.⁶

The United States courts held within a State must take judicial notice of a charter enacted by the State legislature in a public law.⁷ And under the act of Congress of May 26,

¹ *State v. Vincennes University*, 5 Ind. 77, 91; *White Water, &c. Canal Co. v. Boden*, 8 Blackf. 130; *Williams v. Union Bank*, 2 Humph. 339.

² *Stribbling v. Bank of the Valley*, 5 Rand. 138.

³ *Beaty v. Knowler*, 4 Pet. 152; *Young v. Bank of Alexandria*, 4 Cranch, 384; *Stribbling v. Bank of the Valley*, 5 Rand. 132, 138; and see *supra*, § 20.

⁴ *Bank of Utica v. Magher*, 18 Johns. 341.

⁵ *Chapman v. Colby*, 47 Mich. 46; *United States Bank v. Stearns*, 15 Wend. 314; *Society, &c. v. Young*, 2 N. H. 310; *State v. Carr*, 5 N. H. 367; *Hahnemannian Life Ins. Co. v. Beebe*, 48 Ill. 88.

⁶ *Society, &c. v. Young*, 2 N. H. 310, 312; *National Bank v. De Bernales*, 1 Car. & P. 569.

⁷ *Covington Drawbridge Co. v. Shepherd*, 20 How. 227.

1790, subsequently re-enacted, a charter granted by the legislature of one State may be proven in another State, by the production of a certified copy having the seal of the State affixed.¹

§ 40. *Proof of Acceptance.*—The general rule is, that no particular form need be followed in accepting a charter of incorporation. Any acts indicating an intention to accept are sufficient.² It follows, therefore, that proof of any acts of the grantees of a charter, such as a user of the franchises, or of any circumstances from which an intention to accept the franchises may be inferred, is sufficient to establish acceptance.³ It has been held that grants of franchises beneficial to a corporation may be presumed to have been accepted, in the absence of evidence to the contrary.⁴

In case of a corporation formed under a general law, it is apparent that proof that the corporation was organized in accordance with the forms prescribed by the law is sufficient to establish that the corporators have accepted the franchises conferred by the law.

It has been held that the books of a corporation are the best evidence that its charter has been accepted, and that evidence of user of the corporate franchises should be admitted only after the absence of the records has been accounted for.⁵

The books of a corporation are admissible against the company and its members only on the principle that they are admissions; they are not evidence against strangers.⁶ And no reason is obvious why an entry on the private records of a company should be deemed better evidence of the acceptance of a grant of franchises than public user of the rights conferred.

¹ *United States v. Johns*, 4 Dal-
las, 412; s. c. 1 Wash. C. C. 363.

² *Supra*, § 23.

³ *Russell v. McLellan*, 14 Pick.
63; *School District v. Gibbs*, 2
Cush. 39; *Sumrall v. Sun Mutual*
Ins. Co., 40 Mo. 27; *Hammond v.*
Straus, 53 Md. 1; *State v. Sibley*,
25 Minn. 387.

⁴ *Bank of United States v. Dan-*
tridge, 12 Wheat. 64, 70; *Bangor*,
O. & M. R. R. Co. v. Smith, 47 Me.
34; *Owen v. Purdy*, 12 Ohio St. 73;
Stirling v. Vaughan, 11 East, 623;
Talladega Ins. Co. v. Landers, 43
Ala. 115, 136.

⁵ *Hudson v. Carman*, 41 Me. 84.

⁶ 1 Wharton on Ev. § 661.

The question whether or not an act of incorporation has been accepted, is a question of fact, to be passed upon by the jury.¹

§ 41. **Proof of Performance of Conditions Precedent.**—In order to prove the legal existence of a corporation it is necessary to show that every condition precedent, subject to which the franchise of forming the corporation was conferred, has been complied with. Thus, it is essential, in order to establish the incorporation of a company under a general law, to show that all formalities prescribed by the law have been followed.

In *Mokelumne Hill Mining Co. v. Woodbury*,² Cope, J., said: "The general rule is that the existence of a corporation may be proved by producing its charter and showing acts of user under it; but this rule has no application to a corporation formed under the provisions of a general statute requiring certain acts to be performed before the corporation can be considered *in esse*, or its transactions possess any validity. The existence of a corporation thus formed must be proved, by showing at least a substantial compliance with the requirements of the statute."

§ 42. **Proof of Formation of Corporation.**—Proof of the grant of a charter and its acceptance by the grantees merely establishes the right of the grantees to form a corporation; it does not establish that the grantees have actually formed a corporation under the charter. The formation of a corporation results from an agreement between the corporators, and this must be proven as an independent fact.³

Any evidence showing an intention to form a corporation, as, for example, a user of a corporate name or corporate franchises, is sufficient to establish the formation of a corporation by the grantees of a charter. A vote of the grantees accepting the charter is ordinarily in itself sufficient to indicate an

¹ *Hammond v. Straus*, 53 Md. 1. *International Bank*, 21 N. Y. 542;

² 14 Cal. 424; and see cases *Eagle Works v. Churchill*, 2 Bosw. 166; *Barrett v. Mead*, 10 Allen, 337; *Marsh v. Astoria Lodge*, 27 Ill. 421. *supra*, §§ 27-30. Compare *Metho-*
dist Episcopal Church v. Pickett, 19 N. Y. 482; *Bank of Toledo v.*

³ See *supra*, § 24.

intention on the part of the grantees to organize themselves as a corporation.

Under a general incorporation law, proof of a subscription for shares upon the stock-books, and a compliance with the conditions prescribed by the law, establishes clearly that the subscribers have undertaken to form a corporation under the law. The formation of corporations under general laws will be considered in detail in the following chapter.

CHAPTER II.

THE CONTRACT OF MEMBERSHIP.

PART I.

HOW THIS CONTRACT MAY BE CREATED.

§ 43. **General Nature of the Contract of Membership.**—A corporation aggregate consists of a number of individuals who have agreed between themselves to form a corporate association. The members of a corporation formed for pecuniary profit are ordinarily called shareholders, or stockholders, and the contract by which they are bound together is set forth in a charter, or in articles of association agreed to in pursuance of a general incorporation law. The contract of membership in a corporation is not an ordinary common law contract. The formation of this contract is prohibited and illegal, under the common law in force throughout the United States, in the absence of an enabling act or charter. The liberty of forming a corporation is treated as a special privilege, or franchise, which can be conferred only by legislative act. It is clear, therefore, that the validity of this contract, and the methods by which it may be formed, must depend upon the provisions of the statutory law.

§ 44. Every element which is essential, in the nature of things, to the existence of a contract, must of course be present in the contract of membership in a corporation. There must be contracting parties, and these parties must by their mutual agreement create an obligation between them. Without these elements no true contract is possible. But it is not necessary to bring the contract of membership

in a corporation within any technical classification of common law contracts ; nor does the validity of this contract depend upon a compliance with any form or condition precedent which the common law requires as a prerequisite to the legal recognition and enforceability of a contract, such as the rule requiring a consideration. The proper form of entering into the contract of membership, and its legal force and effect, depend entirely upon the statute under which it is created.

Whether an undertaking to form a corporation without statutory authority, or without fulfilling the requirements of the law, shall or shall not be recognized and given effect by the courts according to the intention of the parties, depends upon the consequences of the common law prohibition against unauthorized corporate associations. This question will be discussed fully in a subsequent chapter.¹ The general rule is, that, if a body of individuals assume to form a corporation and in fact act in a separate capacity, the binding force of their transactions cannot be assailed on the sole ground that they have acted in a corporate capacity without legal authority, if this would work injustice to either of the parties.² And the same principle has been applied as between the shareholders themselves in enforcing their mutual agreement.³

§ 45. It has been pointed out in the preceding chapter that the contract of membership in a corporation is similar in many respects to the contract of membership in a partnership. Each contract creates a kind of status, — that of partner in the one case and that of shareholder in the other, — and from this status devolve certain well-defined rights and obligations, as will be shown hereafter.

A person may become a member of an incorporated association, either by an original contract with the other members of the company, or by substitution in the place of an existing member through a transfer of shares. In the latter case, a complete novation occurs, and the transferee becomes a party

¹ *Infra*, Chapter IX. §§ 715-758.

² *Infra*, §§ 730-734.

³ *Infra*, §§ 721-723.

to the contract of incorporation, while the member whose shares he takes is discharged.¹

§ 46. **Contract to become a Shareholder distinguished.**— It is important to distinguish between the contract of membership actually existing between the shareholders or members of a corporation, and a contract to become a shareholder at a future time; and a contract to become a shareholder at a future time must again be distinguished from a contract to purchase shares which have already been issued.

The contract which exists between the members of a corporation, and which constitutes them a corporate association, is the contract of membership. This contract gives the contracting parties the status of shareholders; it invests them with the continuing rights of shareholders, together with the corresponding liabilities; and the performance of this contract will always be specifically enforced, though a failure to perform rarely presents a ground for an action for damages.² On the other hand, a contract to become a shareholder, or to subscribe for shares in a company at a future day, does not give the contracting party the status of shareholder until after the contract has been fully executed by taking the shares or actually subscribing upon the books; and, upon a failure to perform the contract, the corporation would be entitled to recover only the damages suffered, that is, the difference between the amount which the defendant agreed to pay or contribute on account of the shares, and the value of an equal number of shares in the market.³

A similar distinction exists between a contract of partnership and a contract to form a partnership at a subsequent time. The contract of partnership constitutes the contracting parties partners; but a contract between several persons to become partners thereafter does not of itself make them

¹ *Infra*, § 159.

² *Infra*, §§ 227, 235. Compare §§ 212-217.

³ *Thrasher v. Pike County R. R. Co.*, 25 Ill. 393; *Stowe v. Flagg*, 72 Ill. 397, 402; *Rhey v. Ebens-*

burg, &c. Plank Road Co., 27 Pa. St. 261; *Mt. Sterling Coal Road Co. v. Little*, 14 Bush, 429; *Lake Ontario Shore R. R. Co. v. Curtiss*, 80 N. Y. 219, 223; *Quick v. Lemon*, 105 Ill. 578; and see *infra*, § 61.

partners; and for a failure to carry out the agreement an action at law for damages is the only remedy.¹

A contract to sell shares is a contract between a member of a corporation and a person wishing to become a member, whereby the former agrees that the purchaser shall be substituted in his place. A sale of shares is consummated by a legal transfer of the shares to the purchaser, involving a novation of the contract of membership. The consent of all the members of a corporation is undoubtedly essential to a novation of the contract of any member; but this consent is ordinarily impliedly given in advance through the original contract; or the authority to assent to a substitution of members may be vested in the agents of the company.²

An offer to become a shareholder, when accepted by or on behalf of the other members of the company, constitutes the offerer a shareholder. Thus, where an allotment of shares is required before an applicant can become a shareholder, an application for shares is a mere offer; and this offer ripens into a contract as soon as an allotment has been made and notice thereof sent to the applicant.³

§ 47. **Common Law Agreements to form a Corporation.** — If a number of persons mutually agree to become shareholders in a corporation to be formed by them subsequently, either under a special charter or under some general law, the agreement between the parties is originally made up of a series of ordinary common law contracts. If the parties intend to become shareholders, without further act on their part, immediately after the incorporation of the company, their agreement may very properly be held to include a continuing offer to become shareholders as soon as the corporation shall be formed. This offer may be accepted by the corporation, through its regular agents, after organization, unless previously revoked; by such acceptance the contract of

¹ *Gale v. Leckie*, 2 Stark. 107; *Figes v. Cutler*, 3 Stark. N. P. 139; *Andrewes v. Garstin*, 10 C. B. N. s. 444; *Goldsmith v. Sachs*, 8 Sawy. 110; s. c. 17 Fed. Rep. 726.

² *Harris's Case*, L. R. 7 Ch. App. 587; *Household Fire Ins. Co. v. Grant*, L. R. 4 Exch. D. 216. See *infra*, § 164.

³ *Infra*, § 70.

membership is consummated, and the parties become stockholders in the corporation, with all the resulting rights and liabilities.

Thus, in *Athol Music Hall Co. v. Carey*,¹ a number of persons had mutually agreed to form a corporation, and to contribute a certain amount of capital each. An act of incorporation having been subsequently passed, it was held that the subscribers thereupon became shareholders, and, as such, were liable to pay in the capital which they had agreed to contribute. Wells, J., delivering the opinion of the court, said: "In agreements of this nature, entered into before the organization is formed, or the agent constituted to receive the amounts subscribed, the difficulty is to ascertain the promisee, in whose name alone suit can be brought. The promise of each subscriber 'to and with each other' is not a contract capable of being enforced, or intended to operate literally as a contract to be enforced between each subscriber and each other who may have signed previously, or who should sign afterwards, nor between each subscriber and all the others collectively as individuals. The undertaking is inchoate and incomplete as a contract until the contemplated organization is effected, or the mutual agent constituted to represent the association of individual rights in accepting and acting upon the propositions offered by the several subscriptions. When thus accepted, the promise may be construed to have legal effect according to its purpose and intent, and the practical necessity of the case; to wit, as a contract with the common representative of the several associates. . . . Although this promise was originally voluntary, or in the nature of a mere open proposition, yet, having been accepted and acted on by the party authorized so to do before he attempted to retract it, he has lost the right to revoke. His proposition has become an accepted mutual contract, and is binding upon

¹ *Athol Music Hall Co. v. Carey*, 40 Me. 172; *Haskell v. Sells*, 14 116 Mass. 473; *Ashuelot Boot, &c. Mo. App. 91*; *Buffalo & J. R. R. Co. v. Hoit*, 56 N. H. 548; *Cross Co. v. Gifford*, 87 N. Y. 294, 299. *v. Pinckneyville Mill Co.*, 17 Ill. 54; See *infra*, § 78 *et seq.*
Penobscot R. R. Co. v. Dummer,

him as well as the corporation. The votes of the corporation indicate sufficient authority for the institution of this suit in the corporate name and behalf."

§ 48. A subscription for shares in a corporation thereafter to be formed, under a general law, may be accepted by the board, of directors of the company after organization.¹ In *McClure v. People's Freight Ry. Co.*,² three existing companies had entered into an agreement of consolidation. Before this agreement had been filed with the Secretary of State, as required by law, the defendant subscribed for shares. It appeared that the united corporation subsequently accepted the subscription, and made calls, and that the first call was paid by the defendant. The court held that the defendant was liable as a stockholder, saying, "The subscription was at least a valid proposition to the plaintiff, which became irrevocable the instant of its acceptance."

No particular form of acceptance is essential in order to constitute this proposition to become a shareholder a binding contract. But there must be some unequivocal act on the part of the agents having authority to accept the offer, so that there can be no doubt as to the obligation of the corporation as well as of the subscriber.³

§ 49. **Agreements to subscribe for Shares in a Future Corporation.** — A different case is presented where the parties mutually agree to *subscribe* for shares in a corporation to be formed thereafter. Here there is no unconditional agreement to become shareholders as soon as the corporation shall be formed, but it is contemplated that the parties shall themselves perform an additional act before becoming shareholders; namely, execute the statutory contract of membership by subscription upon the stock-books. It is plain, therefore, that in this case there is no offer which the corporation can

¹ *Red Wing Hotel Co. v. Friedrich*, 26 Minn. 112; *Buffalo & J. R. Co. v. Clark*, 22 Hun, 359. See *infra*, § 86.

² *McClure v. People's Freight Ry. Co.*, 90 Pa. St. 269.

³ *Parker v. Northern Central, &c. R. R. Co.*, 33 Mich. 23; *Northern Central Mich. R. R. Co. v. Eslow*, 40 Mich. 222.

accept, and the parties do not become stockholders, and cannot be charged as such, unless they subsequently carry out their agreement by subscribing for the shares.¹

§ 50. **Enforcement of a Mutual Agreement to become Shareholders in a Future Corporation.**—An offer to become a shareholder in a corporation to be formed thereafter may undoubtedly be revoked at any time before acceptance, whether the offer accompany a contract to take shares or not.² But a mutual agreement to become shareholders, or to subscribe for shares, is binding between the parties as a contract, and cannot be revoked.

There is, however, a difficulty in enforcing the execution of a contract of this description. It is evidently the intention of the parties that the promise of each of them shall inure to the benefit of the corporation when formed, and not to the benefit of the individual parties themselves. Justice would therefore be best attained by enforcing a specific performance of the contract on behalf of the corporation, or by allowing the corporation to sue upon it. There is a serious objection to this course, on the ground that the corporation was not itself a party to the contract.³ But this objection would seem to be of no force in those jurisdictions where a person is allowed to sue on an agreement made for his benefit, though he may not be a party to it. It has repeatedly been held, that, where parties have entered into mutual agreements to make donations to a corporation to be formed thereafter, the corporation when formed may sue for and recover the amount of the donations.⁴

¹ *Lake Ontario Shore R. R. Co. v. Curtiss*, 80 N. Y. 219; *Thrasher v. Pike County R. R. Co.*, 25 Ill. 393; *Strasburg R. R. Co. v. Echternacht*, 21 Pa. St. 220; *Mt. Sterling Coal Road Co. v. Little*, 14 Bush, 429. See *supra*, § 46. Compare *Twin Creek, &c. Road Co. v. Lancaster*, 79 Ky. 552; *Quick v. Lemon*, 105 Ill. 578.

² Compare *Stuart v. Valley R. R. Co.*, 32 Gratt. 147; *Goff v. Win-*

chester College, 6 Bush, 443, and cases *supra*, § 47.

³ *Lake Ontario Shore R. R. Co. v. Curtiss*, 80 N. Y. 219.

⁴ *Griswold v. Peoria University*, 26 Ill. 41; *Robinson v. Edinboro Academy*, 3 Grant's Cas. 107; *Edinboro Academy v. Robinson*, 37 Pa. St. 210; *Reformed Protestant Dutch Church v. Brown*, 17 How. Pr. 287; *Hutchins v. Smith*, 46 Barb.

It is to be observed, that an agreement to become a shareholder thereafter, or to subscribe for shares, would not of itself constitute the party agreeing to subscribe a shareholder, even if made with the corporation directly. And upon a breach of such an agreement by a refusal to take shares or subscribe, the corporation would not be entitled to recover the amount of the shares as a debt, but only the damages actually suffered through the breach of contract.¹ It would be extremely difficult to estimate the amount of damages in a case of this description. If shares have a market value, the measure of damages for a breach of a contract to purchase them is the difference between the market value and the amount agreed to be paid. But when a corporation has been newly organized, its unissued shares have no market value, and the measure of damages resulting to the remaining subscribers or associates from the loss of a subscription would be altogether a matter of speculative opinion.

§ 51. In *Kidwelly Canal Co. v. Raby*,² a number of persons agreed to form a canal company, and application was made to Parliament for an act of incorporation. The defendant made an attempt to withdraw before the incorporation had taken place; but the court held that he could not withdraw, and that he became liable to contribute as a shareholder. Whether the decision in this case be based upon the force of the act of Parliament, or upon common law principles, it evidently effected substantial justice by practically enforcing a specific performance of the agreement which the defendant had entered into.

In *Marseilles Land Co. v. Aldrich*,³ the plaintiff had entered into a contract with a number of persons to form a water-power and land company. It was agreed that the company should carry on business as a partnership or joint-stock com-

235; *Ashuelot Boot, &c. Co. v. Co.*, 25 Ill. 393; *Lake Ontario Shore Hoit*, 56 N. H. 548; *Eastern Plank R. R. Co. v. Curtiss*, 80 N. Y. 219, 223.
Road Co. v. Vaughan, 14 N. Y. 546; ² 2 Price (Exch.) 93.
Ives v. Sterling, 6 Metc. (Mass.) 310; ³ *Marseilles Land Co. v. Aldrich*,
Thompson v. Page, 1 Metc. (Mass.) 565. 86 Ill. 504. Compare *Stowe v. Flag*, 72 Ill. 397; *Batty v. Adams*

¹ *Thrasher v. Pike County R. County*, 16 Neb. 44.

pany until a charter could be obtained from the legislature, and that as soon as a corporation was organized the entire property should be transferred to it, and the stock distributed among the parties in certain fixed proportions. The plaintiff contributed certain machinery as his share of the capital of the association, on these terms, and also paid several assessments for the purpose of carrying on the business. About a year after the company had been formed, a corporation was properly organized, and the entire property transferred to it, in pursuance of the agreement. The plaintiff, however, refused to take the shares which were allotted to him, and filed a bill for an accounting, and to have his undivided share of the property transferred to him. The court decided that the plaintiff was not entitled to this relief, and that he never became entitled to a share in the property *in specie*, but only acquired an equitable right to be treated as a shareholder in the company until a corporation was organized, and thereupon to have his proportionate share of the stock. It was held that the contract would be enforced in equity according to the intention of the parties, and that neither party had a right to terminate his connection with the company and close out the business; that the parties could sell their shares in the concern only subject to the terms of the agreement, and that the secretary of the association was authorized to subscribe the name of each shareholder for his proportionate part of the stock of the corporation at the time of its organization.

§ 52. **Conditions Precedent.** — An offer or contract to become a shareholder in a corporation, or to subscribe for shares thereafter, does not become binding or create a liability until all conditions precedent, upon which the offer or contract was made, have been performed.¹ It is plain that no liability is incurred, unless the corporation which is organized is the specific corporation which was contemplated at the time of the agreement.²

¹ Lake Ontario Shore R. R. Co. 6 Bush, 443; Edinboro Academy v. Curtiss, 80 N. Y. 219; People's Robinson, 37 Pa. St. 210.

Ferry Co. v. Balch, 8 Gray, 310, ² Machias Hotel Co. v. Coyle, 35 311; Goff v. Winchester College, Me. 405; Wallingford Manuf. Co. v.

§ 53. **Preliminary Subscriptions under Statutes.**—In some instances the general incorporation laws provide for a preliminary agreement to take shares, to be signed by those who intend to become shareholders, before any corporation is formed or organized. The effect of an agreement of this character was considered in *Poughkeepsie, &c. Plank Road Co. v. Griffin*.¹ The defendant and others had signed a paper by which each agreed to take a certain number of shares in a corporation, thereafter to be formed under the general law of 1847, and to pay the amount of the shares at such time and place as the trustees might direct. The precise character of the corporation, and the number and amount of the shares of its capital stock, were also set forth in the paper. The process of incorporation, prescribed by the law under which the company was organized, was as follows. A notice was first to be published, pointing out where books for subscribing to the stock would be opened. After stock of a certain amount had been subscribed for, in good faith, and five per cent paid thereon, the subscribers were to elect directors, and then were required severally to subscribe articles of association, setting forth a description of the company, and the name and residence of each subscriber, and the number of shares taken by him. The articles of association were to be filed in the office of the Secretary of State, and thereupon, according to the terms of the act, "the persons who have so subscribed, and all persons who shall, from time to time, become stockholders in such company," should be a body corporate, etc.

The court held that the defendant, who had merely signed the preliminary subscription, and not the articles of association, as required by the terms of the act, did not become a stockholder, and was not liable as a shareholder to contrib-

Fox, 12 Vt. 304; *California Sugar Manuf. Co. v. Schafer*, 57 Cal. 396. Compare *Edinboro Academy v. Robinson*, 37 Pa. St. 210.

¹ *Poughkeepsie & S. P. Plank Road Co. v. Griffin*, 24 N. Y. 150, reversing 21 Barb. 454; *Troy & B.*

R. R. Co. v. Tibbits, 18 Barb. 297; *Same v. Warren*, Id. 310. Compare, however, *Heaston v. Cincinnati, &c. R. R. Co.*, 16 Ind. 282; *Johnson v. Wabash, &c. R. F. Co.*, 16 Ind. 389.

ute the amount of his shares. The question whether the defendant incurred any liability by reason of his agreement to take shares when the corporation should be formed, was not considered.

§ 54. **The Contract of Membership.** — **How formed.** — It may be stated as a general rule, that, in the absence of an express provision in the statute authorizing a corporation to be formed, the presumption is that it may be formed by a simple, voluntary association of its members; in such case, the intention of the shareholders to assume their relationship to each other is the only essential, and no formalities are required. Thus, where a charter of incorporation is granted to a number of individuals unconditionally, their intention to form themselves into a corporation may be manifested by a simple acceptance of the charter; or it may be shown by their acts, in exercising the authority conferred upon them.¹

The same rule applies to the adoption of an amended charter or constitution by an existing corporation. No special forms are required to give validity to the intentions of the parties, unless expressly prescribed by law.²

A failure to comply with the prescribed formalities in forming a corporation under a general law or charter, does not necessarily render the acts of the parties wholly ineffective. It does not prevent the existence of a corporation *de facto*, but only affects the legal validity of the organization, and the enforceability of the contract of membership.³

§ 55. **Statutory Subscriptions for Shares.** — General incorporation laws and special charters usually prescribe in detail the methods by which corporations shall be formed under them. In these cases, of course, the statutory method must be followed, and the common law rules governing the formation of ordinary contracts have no application.

The point of time at which a corporation is formed, and the contract of membership between the shareholders consummated, necessarily depends, in each case, upon the provisions of the statute under which the parties have acted. In

¹ *Supra*, § 25. *Bates County v. Winters*, 112 U. S. 325.

² *Infra*, § 603.

³ *Infra*, § 721.

some instances, it is provided by law that persons wishing to form a corporation shall sign articles of association, setting forth the character and purposes of the company to be formed, the amount of its capital stock, and the number of shares taken by each of the subscribers, and shall file the articles with the Secretary of State or some other public officer; and that, upon filing the articles, the subscribers shall become a body corporate, and shall organize a company by calling a meeting and electing officers. Here the contract of membership between the subscribers is consummated, and they become stockholders in a corporation from the time of filing the articles of association.

In other instances, the formation of the corporation is not complete until the subscribers have organized, or other conditions precedent have been complied with. Thus, under some statutes, the persons desiring to form a corporation must first file a certificate setting forth a description of the corporation; after having obtained a license, they are authorized to act as statutory commissioners, and to open subscription-books for shares in the company. After the whole or a specified portion of the capital has been thus subscribed, the commissioners must call a meeting of the subscribers for the purpose of adopting a corporate organization. A record of the stock subscriptions and the organization proceedings must then be filed with the Secretary of State, or some public officer whose duty it is to issue a certificate of incorporation or license to the company, if the provisions of the law have been complied with. In this case, the subscribers for shares become stockholders, and the incorporation is complete as soon as the certificate or license has been issued to the company.

§ 56. **Effect of a Statutory Subscription for Shares.**—A vague notion appears to have been entertained in some cases that a statutory subscription for shares is a mere offer or common law agreement to take shares and pay for them thereafter, or, in other words, an executory contract of sale. This idea is entirely erroneous. The statutory subscription itself constitutes the subscriber a shareholder, and the liability to

pay the amount of the shares is merely an incident to the contract of membership; it is like the liability of a partner to contribute his share of capital as fixed by the partnership articles. The contract of the shareholders of an incorporated association is in reality, though not in form, a mutual contract, like that between the members of an unincorporated association, and the existence of the association is in each case but a result of this contract. Where the stock subscriptions are made before incorporation, the contract of membership is consummated at the moment at which all conditions precedent prescribed by law have been complied with. At this moment the subscribers assume the status of shareholders.¹ They become entitled to all the rights and privileges of members of the corporation; they may vote at corporate meetings,² claim a share in the profits of the common venture, and generally may compel a specific performance of the contract of membership.³ They also become liable to all the obligations of stockholders, and must contribute the amount of capital subscribed by them for the common good.⁴

The issuing of a certificate of shares is never essential to constitute a subscriber or a transferee of shares a stockholder; it is merely evidence of his right, and may be demanded by the stockholder by virtue of his rights of membership.⁵

¹ See *Waukon & M. R. R. Co. v. Dwyer*, 49 Iowa, 121; *Burrall v. Bushwick R. R. Co.*, 75 N. Y. 211, 217; *United Society v. Eagle Bank*, 7 Conn. 457; *Selma & T. R. R. Co. v. Tipton*, 5 Ala. 809; *Buffalo & N. Y. City R. R. Co. v. Dudley*, 14 N. Y. 337; and cases in the following notes.

² *Beckett v. Houston*, 32 Ind. 393.

³ *Fry v. Lexington, &c. R. R. Co.*, 2 Metc. (Ky.) 322, 323; *Pacific R. R. Co. v. Hughes*, 22 Mo. 291; and see *infra*, §§ 109, 116.

⁴ *Buffalo & N. Y. City R. R. Co. v. Dudley*, 14 N. Y. 337; *Lake Ontario, A. & N. Y. R. R. Co. v. Mason*,

16 N. Y. 451-463; *Phoenix Warehousing Co. v. Badger*, 67 N. Y. 298; *Northern R. R. Co. v. Miller*, 10 Barb. 260; *Spear v. Crawford*, 14 Wend. 20.

⁵ *Rutter v. Kilpatrick*, 63 N. Y. 604; *Wheeler v. Millar*, 90 N. Y. 353; *Burr v. Wilcox*, 22 N. Y. 551; *Thorp v. Woodhull*, 1 Sandf. Ch. 411; *Johnson v. Albany, &c. R. R. Co.*, 40 How. Pr. 193; *Chaffin v. Cummings*, 37 Me. 83; *Schaeffer v. Missouri Home Ins. Co.*, 46 Mo. 248; *Chester Glass Co. v. Dewey*, 16 Mass. 94; *Boston & Albany R. R. Co. v. Pearson*, 128 Mass. 445; *Beckett v. Houston*, 32 Ind. 393; *Slipher*

§ 57. **Whether Subscription of entire Capital a Condition Precedent.** — The subscription of the entire capital provided by the articles of association or charter of a corporation is ordinarily not a condition precedent to the consummation of the contract of membership and the formation of a corporation.¹ The provisions of the charter or law of incorporation must, however, prevail; and if it appears to be the intention of the legislature that the entire stock shall be subscribed before the incorporation shall take effect, the subscribers will not become shareholders in a corporation until that time.² It is to be observed, that there is a plain distinction between the completion of the contract of membership resulting in the formation of a corporation, and the right of the company to begin to carry on business and levy assessments on its shareholders. Corporations that have been formed and fully organized frequently have no right to begin the prosecution of their main enterprises, or levy assessments for that purpose, until after the whole capital has been subscribed.³

§ 58. **Excessive Subscriptions. — Allotment.** — Where shares in excess of the amount allowed by the charter of a corporation are subscribed after the corporation has been formed, it is evident that the additional subscriptions do not alter the contract between the existing members; the subscriptions made after the full amount has been subscribed are void, and the subscribers do not become members of the corporation.⁴ But if the law provides for an apportionment or allotment of shares among all the subscribers, and if the amount of shares is not sufficient to satisfy all the subscriptions, it is evident that the contract between the subscribers remains incomplete until after an apportionment or allotment has been made.⁵

v. Earhart, 83 Ind. 173; *Haynes v. New Hampshire Cent. R. R. Co. v. Brown*, 36 N. H. 545, 563; *Fulgam v. Johnson*, 30 N. H. 390, 407.

Macon, &c. R. R. Co., 44 Ga. 597; ² *Franklin Fire Insurance Co. v. Hart*, 31 Md. 60.

South Georgia & F. R. R. Co. v. Ayres, 56 Ga. 230; *Minneapolis* ³ *Infra*, §§ 137-156.

Harvester Works v. Libby, 24 Minn. ⁴ *Infra*, §§ 741-746.

327; Mitchell v. Beckman, 64 Cal. ⁵ *Walker v. Devereaux*, 4 Paige, 229; *Crocker v. Crane*, 21 Wend. 211;

117; and see cases *infra*, §§ 148, 453. *Buffalo & N. Y. City R. R. Co. v. Dudley*, 14 N. Y. 346. See *infra*, § 70.

¹ *Supra*, § 29; *Hughes v. Antietam Manuf. Co.*, 34 Md. 328, 329;

The effect of a provision in a charter for the distribution of shares, in case of an excess of subscriptions over the amount of the company's capital stock, was considered in *Buffalo, &c. R. R. Co. v. Dudley*.¹ The court said: "If no more than the amount was subscribed, the commissioners had no power to distribute, and the several subscribers would be stockholders holding the number of shares respectively taken. Had it been shown that the amount subscribed before the books were closed was greater than the whole capital, the plaintiff would have been compelled to prove, in order to fix the defendant's liability, that the amount subscribed, or some other amount, had been awarded to him in the distribution; because, in such a case, as the amount of stock cannot be increased, a distribution becomes necessary in order to determine who are the stockholders, and the number of shares each is entitled to, and the subscriptions are made subject to such right or power of distribution, if the state of the subscription shall render its exercise necessary. The presumption of law, however, must be, I think, that the books were closed the moment the stock was all taken by subscription, and thus the title of the several subscribers to the number of shares respectively taken, subject to forfeiture by the directors for nonpayment, became perfect the moment the books were closed."

§ 59. **Subscriptions are binding from the Time they are made.** — Although the contract by which stock subscribers become members of a corporation does not go into effect until all conditions precedent have been complied with, and the corporation is created, yet it does not follow that the subscribers are not bound by their subscriptions from the time they are made. The contract of the subscribers is not a contract with the corporation, but a contract between themselves. It has been held that a mutual contract to become shareholders in a corporation to be formed thereafter is binding, even at common law.² The contract between the statutory subscribers,

¹ *Buffalo & New York City R. R. Co. v. Wilson*, 22 Conn. 436, *R. Co. v. Dudley*, 14 N. Y. 336, 453.

346. See also *Danbury & Norwalk* ² *Supra*, §§ 47-50.

however, depends for its validity upon the statute under which the corporation is formed, and not merely upon the common law; and it seems but a reasonable inference, that the intention of the legislature in providing for the opening of stock-books was to make a subscription binding from the time it was made. Otherwise, the greatest facility would be given for practising frauds upon innocent subscribers, by means of subscriptions intended merely as a decoy.¹

In *Lake Ontario, &c. R. R. Co. v. Mason*,² Brown, J., said: "If the contract to pay for and take the stock was a valid contract, made upon a sufficient consideration, then his subscription was not open to revocation. Until the incorporation of the company was perfected, the other subscribers had an interest in its execution and performance, of which they could not be deprived by the act of the defendant; and after the articles were filed and recorded in the secretary's office, and the corporation had a legal existence, it acquired a vested interest in the defendant's agreement."

Certain incorporation laws in New York made provision for a preliminary subscription for shares before the articles of association were signed, yet only those who signed the articles became stockholders in the corporation. It was held that the preliminary subscription was intended merely to bring the parties together, and was not binding.³ A different conclusion was reached in Indiana, under a similar statute.⁴

§ 60. **Subscriptions after Organization.** — Where shares in a corporation are subscribed for pursuant to a statute, before the company has been organized, the engagement between the subscribers is created directly by the act of subscription. But this method of creating the contract of mem-

¹ See *infra*, § 107. *Connecticut Dillsburg, &c. R. R. Co.*, 78 Pa. St. 465. See also *Hughes v. Antietam* 476-478. See *Greer v. Chartiers Manuf. Co.*, 34 Md. 328, 329. *Ry. Co.*, 96 Pa. St. 391.

³ See *supra*, § 53.

² *Lake Ontario, &c. R. R. Co. v. Mason*, 16 N. Y. 451, 463, *contra* *Burt & Farrar*, 24 Barb. 518; *Garrett v. Heaston v. Cincinnati, &c. R. R. Co.*, 16 Ind. 282; *Johnson v. Wabash, &c. R. R. Co.*, 16 Ind. 389.

bership is ordinarily not applicable after the company has been fully formed and organized. The statutory subscription is provided merely as a means of bringing the association into being; after the association has been organized, there is obvious propriety in treating the admission of new members as a matter to be regulated by the association itself, through its regular agents.

Accordingly, it has been held that a subscription for shares made after the organization of a corporation does not become binding, or constitute the subscriber a shareholder, until it has been accepted by the company through its proper agents.¹

§ 61. **Difference between Sales of Shares and Subscriptions.**—The issue of new shares by a corporation may take the form either of a sale and purchase of the shares, or of an ordinary subscription. There is an important difference between the two classes of contracts. When a person agrees “to take” or “to purchase” shares, the intention is to buy the certificates representing the shares, as salable securities. In this case, therefore, the delivery of the certificates and the payment of the amount of the shares are intended by the parties to be concurrent acts; and, upon a failure to carry out the contract, neither party can charge the other without averring a tender of performance.² As the purchaser does not become a shareholder until he has received the certificates, a breach of the agreement will render him liable only to the extent of the damages which the company has actually suffered.³ On the other hand, the effect of an ordinary subscription is to constitute the subscriber a shareholder immediately, with the right to vote at meetings and share in dividends, and subject to a liability to contribute the amount of the shares when called upon or assessed by the directors. The subscriber

¹ *Carlisle v. Saginaw Valley, &c. ment Co.*, 57 Ind. 138; *Weiss v. R. R. Co.*, 27 Mich. 318; *Parker Mauch Chunk Iron Co.*, 58 Pa. St. 295, 301; *Quick v. Lemon*, 105 Ill. 33 Mich. 23; *Northern Central* 578.
Mich. R. R. Co. v. Eslow, 40 Mich. 222.

³ *Thrasher v. Pike County R. R. Co.*, 25 Ill. 393, 405; and see *supra*, § 46.

² *Clark v. Continental Improve-*

upon becoming a shareholder would in each case be invested with the resulting rights and liabilities. The delivery or tender of a certificate of shares is never a condition precedent to the liability of a shareholder to contribute the amount of his shares after a proper call has been made.¹

In *St. Paul, &c. R. R. Co. v. Robbins*,² an agreement, purporting on its face to be a subscription for shares in a corporation already organized, was construed by the court as an agreement to buy certificates of shares, and it was held that the delivery of the certificates and payment of the purchase price should be concurrent acts.

In *Minneapolis Harvester Works v. Libby*,³ the defendant had in terms subscribed for shares and agreed to pay the amount of the same in four equal annual instalments; and it was held that the corporation was under no obligation to aver a tender to the defendant of a certificate of shares in order to maintain a suit to recover the first three instalments, which had matured.

¹ *Supra*, § 58.

² *St. Paul, S. & T. F. R. R. Co. v. Robbins*, 23 Minn. 440. Gilfillan, C.J., delivering the opinion of the court, said: "It appears from the complaint, that at the time of this subscription the company was fully organized, so that it does not stand upon precisely the same footing as a subscription made prior to, and for the purpose of effecting, the organization. Such a subscription gives to the subscriber an interest in the corporation, and the right to take part in organizing it, and this interest and right are a sufficient consideration to support his promise. But the subscription in this case does not appear to have been to the original stock; on the contrary, it appears that, after the company was fully organized, its board of directors authorized and directed the issuance of what, in the amended complaint, is called 'preferred capi-

tal stock,' and also directed that the company's books should be opened to receive subscriptions for the same. The mere subscription to this stock, while it constitutes a valid contract on the part of the company to issue the stock to the defendant upon his paying for it, and, on his part, to receive and pay for it, does not give him an interest in the company, nor vest in him the title to the stock. It can be sustained as a contract only on the implied contract of the company to issue the stock to him. . . . We regard the two promises as concurrent and dependent, and that neither party could require the other to perform without performing or offering to perform the promise on his part. As plaintiff has neither issued the stock, nor offered to issue it, the action is prematurely brought."

³ *Minneapolis Harvester Works v. Libby*, 24 Minn. 327.

In the latter case the court said: "If the action were brought to recover the full price of the shares, or the whole or so much of the price as remained unpaid, such averments would, we think, be necessary, upon the principle of the case of *St. Paul, &c. R. R. Co. v. Robbins*. The obligation to issue and deliver the stock would probably be regarded as concurrent with the obligation to make full payment therefor; but the present action is brought to recover, not the full price, or so much thereof as is unpaid, but three fourths of such price only,—the remaining fourth not having fallen due." The view here expressed appears to be based on a misapprehension of the nature of the defendant's liability. The defendant had not merely agreed to become a stockholder after paying four annual instalments, but he had actually become a stockholder. By virtue of his membership in the company, he was liable absolutely to contribute the amount of his shares as agreed upon, and was entitled to have certificates representing his shares (paid up or partially paid up, according to circumstances) issued to him by the corporation.¹

Whether a contract with a corporation is a contract to purchase shares, or a contract of present membership, depends on the intention of the parties. If payment of the price and delivery of the certificates are intended to be concurrent acts, the transaction will clearly be a purchase and sale. But if it is contemplated that the party contracting with the company shall have any of the rights of the shareholder before the whole amount of the shares has been paid, the contract must be treated as a contract of membership.

§ 62. **Mutual Assent is Necessary.**—It is clear that the contract of membership in a corporation, like any other contract, cannot be created without the mutual consent of the parties. Hence, if a person's name is placed upon the subscription-books of a corporation without his authority or consent, the subscription will not bind him.²

¹ *Infra*, § 453.

Lang, 63 Me. 480; *McClelland v.*

² *Ticonic Water Power Co. v. Whiteley*, 15 Fed. Rep. 322.

So, if articles of association are signed in an incomplete state, the subscriber will not be liable unless he has given authority to complete the instrument afterwards. Thus, the Court of Appeals of New York held that a subscriber to articles of association of a railroad company, in which the place for the names of the directors of the company had been left blank, was not bound by his subscription, he having given no consent, either express or implied, to the completion of the instrument.¹ Johnson, J., said: "When articles in an incomplete state are circulated in order to procure subscriptions, the mere signing of them cannot be regarded as binding the signer to abide by such filling up of blanks and supplying of wanting provisions as any one may choose to insert. In such case, the signing is merely preliminary in character, and can only become binding upon the signer by his assent to the completion of the paper. . . . The findings in this case negative any consent in any form, express or implied, and of course we must treat the question on that basis. . . . Whether the preliminary consent is given upon a separate and different paper from that which is to become the articles of association, or whether the paper signed is that which, when completed, is to be the actual articles of association spoken of in the statute, can make no difference. The principle is only, that consent is necessary to the making of a contract, and that the statute does not introduce any different rule."²

§ 63. The same principle applies where a number of persons agree to unite in the formation of a corporation, have specified purposes, and a portion of the subscribers afterwards organize a corporation with other purposes. In this case, an original subscriber who has not united in organizing the company cannot be treated as a shareholder, or held liable on his agreement, for the reason that he never agreed

¹ The law of New York under which the company was formed expressly provided that the names of the first directors should appear in the articles. Laws of 1850, ch. 140. Mabbett, 58 N. Y. 397; Bucher v. Dillsburg, &c. R. R. Co., 76 Pa. St. 306. Compare Eakright v. Logansport & N. R. R. Co., 13 Ind. 404; and Reed v. Richmond Street

² Dutchess & C. C. R. R. Co. v. R. R. Co., 50 Ind. 342.

to become a shareholder in the company which is actually formed.¹

In *Southern Hotel Co. v. Newman*,² it was held that the defendant in a suit brought by a corporation upon a subscription for shares was entitled to show as a defence that the subscription list which he had signed, and upon which suit was brought, had been annulled and abandoned by mutual consent of the parties, and that another subscription list had been subsequently opened and made the basis of the corporate organization.

A person subscribing for shares as agent for another, but without authority, does not become a shareholder in place of the principal whose name he subscribed; the unauthorized subscription will merely subject him to an action for damages.³ However, if a person acts as agent for another without his authority, the want of authority may generally be cured by a subsequent ratification; and therefore, although a subscription for shares in a corporation may have been made originally without the consent or authority of the person whose name was subscribed, he will nevertheless be held a shareholder, if he afterwards ratified or adopted the subscription.⁴ So where the articles of association are altered, or where an attempt is made to transfer a subscription to a new company, the subscriber will be liable if he has consented to the change, either by word or by act indicating acquiescence.⁵

¹ *Dorris v. Sweeney*, 60 N. Y. 463; *Burrows v. Smith*, 10 N. Y. 550; *Mahan v. Wood*, 44 Cal. 462; *Richmond Factory Ass. v. Clarke*, 61 Me. 351; *Katama Land Co. v. Jernegan*, 126 Mass. 155; *Richmond Street R. R. Co. v. Reed*, 83 Ind. 9.

² *Southern Hotel Co. v. Newman*, 30 Mo. 118.

³ *Salem Mill Dam Co. v. Ropes*, 9 Pick. 187; *contra*, *State v. Smith*, 48 Vt. 266. Compare *Burr v. Wilcox*, 22 N. Y. 551; *Troy & B. R. R. Co. v. Warren*, 18 Barb. 310. See *infra*, § 835.

⁴ *McCully v. Pittsburgh, &c. R. R. Co.*, 32 Pa. St. 25; *Diman v. Providence, &c. R. R. Co.*, 5 R. I. 130; *Musgrave v. Morrison*, 54 Md. 161, 165; *Philadelphia, W. & B. R. R. Co. v. Cowell*, 28 Pa. St. 329; *Mississippi & T. R. R. Co. v. Harris*, 36 Miss. 17. See *Putnam v. New Albany*, 4 Biss. 365. Compare *Rutland & B. R. R. Co. v. Lincoln*, 29 Vt. 206, and cases in the preceding notes. See also *infra*, § 823.

⁵ *Hammond v. Straus*, 53 Md. 1, 16.

§ 64. **What Agents can receive Subscriptions.** — If the general law or charter under which a corporation is formed provides that subscriptions for shares shall be received by agents of a particular class, no other agents can bind the company or the other subscribers by receiving subscriptions on their behalf. Upon this principle, it has been held that, if the power of allotting shares to applicants is conferred upon the board of directors, they cannot delegate this power to a committee of three of their number, and no valid allotment can be made except by the board.¹

The general railroad law of Michigan provided that, after a company had been formed by subscriptions for shares to a certain amount per mile of the proposed road, and after articles of association had been adopted and the corporation organized, the commissioners named in the articles of association should open books for subscriptions and keep the same open until all the capital had been subscribed, and in case of an excess of subscriptions should make a distribution among the subscribers. It was held by the Supreme Court, that only the commissioners could receive subscriptions under this law, and that a subscription received by an agent appointed by the directors was not binding. The court said: "The commissioners act as a statutory board, and derive their powers from the law, and not from the corporation. They are expressly required to give notice of the times and places fixed by them for receiving subscriptions, and to keep their subscription books open. The design of the law was to enable all persons to subscribe upon equal terms. No one else was authorized to receive subscriptions, and they were not required to recognize and protect, in their distributions of stock, any stock not subscribed for on their own lists."²

§ 65. If a subscription is not binding because it was received by an agent having no authority to receive it on

¹ Howard's Case, L. R. 1 Ch. Mich. 23; Northern Central Mich. R. R. Co. v. Eslow, 40 Mich. 222; App. 561.

² Shurtz v. Schoolcraft, &c. R. R. Essex Turnpike Co. v. Collins, 8 Co., 9 Mich. 269, 272; Parker v. Mass. 292; *contra*, Railroad Co. v. Northern Central, &c. R. R. Co., 33 Rodrigues, 10 Rich. Law, 278.

behalf of the corporation, the want of authority may be cured by subsequent ratification through the proper agents;¹ and an irregular subscription, made before the complete incorporation of the company, may be treated as an open offer, which may be accepted by the corporation after organization.²

The directors of a corporation have usually implied authority to dispose of any unsubscribed shares in the company, for cash. Whether they are bound to observe the same forms and conditions which limit the powers of commissioners before organization in receiving subscriptions, depends upon the terms of the company's charter. But the general rule is that they are not so limited, unless the contrary appears to be intended.³

§ 66. **Powers of Agents receiving Subscriptions.** — The authority of agents or commissioners appointed by law to receive subscriptions for shares is limited strictly to the duties which they are required to perform.⁴ They cannot, unless specially authorized, refuse to receive a subscription made by a competent person,⁵ or release a subscription when once made,⁶ nor can they accept subscriptions made upon special conditions.⁷ But they may very properly require a person offering to subscribe in the name of another to produce satisfactory evidence of his authority to do so;⁸ and they are authorized to take measures to make sure that the subscriptions are made in good faith, and in proper form, by competent parties.

If an act of incorporation appoints certain commissioners to receive subscriptions and to apportion the stock among the subscribers, the commissioners act ministerially in receiving

¹ Walker v. Mobile, &c. R. R. Co., 34 Miss. 245; Mobile & O. R. R. Co. v. Yandal, 5 Sneed, 294. 1 Head (Tenn.), 659, 665, and cases below.

² *Infra*, § 86. Buffalo & J. R. R. Co. v. Gifford, 87 N. Y. 294, 299. ⁵ Crocker v. Crane, 21 Wend. 211; Carlisle v. Saginaw Valley, &c. R. R. Co., 27 Mich. 318.

³ Philadelphia & W. C. R. R. Co. v. Hickman, 28 Pa. St. 318, 327; Erie & W. Plank Road Co. v. Brown, 25 Pa. St. 158; Pittsburgh & C. R. R. Co. v. Stewart, 41 Pa. St. 54, 58. ⁶ Lowe v. E. & K. R. R. Co., 1 Head (Tenn.), 659; and see *supra*, § 59; *infra*, § 109.

⁴ See Lowe v. E. & K. R. R. Co., 234. ⁷ *Infra*, § 83.

⁸ State v. Lehre, 7 Rich. Law,

the subscriptions, and any one may act though no majority be present; but in apportioning the stock among the subscribers they act judicially, and must meet to hear and consult as a board.¹

Under a law investing the commissioners with authority to distribute the stock in such a manner as they shall deem most advantageous to the corporation, they are not obliged to make a ratable distribution among all the subscribers, but it is contemplated that they shall use their discretion in selecting the best men.²

§ 67. **Formalities prescribed by Law.**— If the charter or general law under which a corporation is about to be formed requires certain formalities to be observed in becoming an original member of the company by a subscription for shares, a subscription made without complying with the prescribed formalities does not constitute a binding contract. This follows, both because the association of the subscribers, if not made in the manner prescribed by law, would be unauthorized and therefore illegal at common law, and also because the mutual assent of the associates would in such case be wanting.³ Every subscription by implication refers to and incorporates the terms of the charter or general law under which the corporation is to be formed; and every subscriber agrees to become associated with the others only upon condition that the formalities prescribed by the charter shall be observed in making the mutual contract. Thus, if certain preliminaries, such as the filing of a certificate, are required to be performed after the articles of association have been subscribed, but before the corporation shall be in existence, the contract of membership does not go into effect until these formalities are complied with; and a subscriber to the articles cannot until then be made to contribute the amount of his subscription.⁴

¹ Crocker v. Crane, 21 Wend. 211.

² Perkins v. Savage, 15 Wend. 412; Walker v. Devereaux, 4 Paige, 229; Clarke v. Brooklyn Bank, 1 Edw. Ch. 361. Compare Meads v. Walker, Hopk. Ch. 587.

³ *Infra*, § 717. With regard to formalities in becoming a stockholder in a corporation by transfer of shares, see *infra*, § 169 *et seq.*

⁴ Monterey & S. V. R. R. Co. v. Hildreth, 53 Cal. 123; De Witt v.

§ 68. **After Incorporation.** — The same principles apply where a subscription for shares in a corporation already in existence is made without complying with the formalities prescribed by its constitution. The irregular subscription will not bind the company nor the subscriber.¹ Thus, it was decided by the Supreme Court of Michigan, that, under a law providing that the members of a corporation should consist of the original subscribers and such other persons as should subscribe or become shareholders in the company, "in the manner to be provided by its by-laws," there could be no further subscriptions after a corporation had been formed until by-laws had been enacted; and that a subscription made before the enactment of by-laws was not binding.²

A contract of membership in a corporation will be held valid, if the requirements of the charter or act of incorporation have been substantially complied with.³ And where no formalities are prescribed, any agreement by which a person shows an intention to become a shareholder, upon the terms set forth in the company's charter, is sufficient.⁴ If the charter contains no provision regulating the admission of new shareholders, nor any restriction, the whole matter is left within the control of the corporation, and regulations may be provided through by-laws.⁵

§ 69. **Form of Subscriptions upon Books.** — If the charter under which a corporation is formed provides that persons wishing to become members of the company shall subscribe for shares upon stock-books, this evidently contemplates that the contract between the shareholders shall be made in writ-

Hastings, 69 N. Y. 518; Childs v. Smith, 55 Barb. 45, 57; Dorris v. Sweeney, 60 N. Y. 463; Katama Land Co. v. Holley, 129 Mass. 540; Rikhoff v. Brown's, &c. Machine Co., 68 Ind. 388; Indianapolis Furnace, &c. Co. v. Herkimer, 46 Ind. 142; Nelson v. Blakey, 47 Ind. 38; Reed v. Richmond, &c. R. R. Co., 50 Ind. 342; McIntire v. McLain, &c. Ass., 40 Ind. 104; Richmond Factory Ass. v. Clarke, 61 Me 351. See Kansas City Hotel Co. v. Hunt, 57 Mo. 126; Galvanized Iron Co. v. Westoby, 8 Exch. 17; Wilkinson v. Gold Mining Co., 18 Q. B. 728. *Infra*, § 719.

¹ *Infra*, §§ 717-719.

² Carlisle v. Saginaw Valley, &c. R. R. Co., 27 Mich. 315.

³ *Supra*, § 32.

⁴ *Supra*, § 54.

⁵ See State v. Sibley, 25 Minn.

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ing, and according to the forms provided; and hence an oral agreement will not under these circumstances be sufficient to constitute the contractor a shareholder.¹ This, however, has no application to a contract to purchase certificates of shares, and to become a shareholder in a corporation, after it has been fully organized. It has been pointed out that a contract of this description does not constitute the person dealing with the company a shareholder, until a certificate has been delivered to him, and his name entered upon the stock-books.² A contract for the sale of stock certificates is governed by the same rules and statutes which govern contracts for the sale of other transferable securities.³

No particular form of subscription is essential. The subscription paper must be read in connection with the charter or articles of association to which it refers, and it is sufficient if it indicates that the subscriber intended to become a shareholder in the corporation and fixes the amount of his shares.⁴

Under a statute providing for subscriptions upon *books*, subscriptions are valid if made upon unbound sheets of paper.⁵ In *Brownlee v. Ohio, &c. R. R. Co.*,⁶ it was held that a subscription obtained by an agent in a small blank book, and afterwards accepted by the company, was binding, and that it was not necessary to transfer it to the stock-books, inasmuch as its acceptance by the company would make the book in which it was made the stock-book to that extent.

In *Iowa & Minn. R. R. Co. v. Perkins*,⁷ the defendant was held liable under the following circumstances. At a meeting held for the purpose of obtaining subscriptions, a num-

¹ *Vreeland v. N. J. Stone Co.*, 29 N. J. Eq. 188, 191; *Pittsburgh, &c. R. R. Co. v. Gazzam*, 32 Pa. St. 340; *Fanning v. Insurance Co.*, 37 Ohio St. 339; *Thames Tunnel Co. v. Sheldon*, 6 B. & C 341. Compare *Bates County v. Winters*, 112 U. S. 325.

² *Supra*, § 61.

³ *Infra*, § 226.

⁴ *Nulton v. Clayton*, 54 Iowa, 425; *Ashtabula, &c. R. R. Co. v. Smith*,

15 Ohio St. 328. Compare *Grangers' Market Co. v. Vinson*, 6 Oreg. 174.

⁵ *Hamilton, &c. Plank Road Co. v. Rice*, 7 Barb. 157; *Ashtabula, &c. R. R. Co. v. Smith*, 15 Ohio St. 328. See *Buffalo, &c. R. R. Co. v. Gifford*, 87 N. Y. 294.

⁶ 18 Ind. 63.

⁷ 28 Iowa, 283. See also *Stuart v. Valley R. R. Co.*, 32 Gratt. 146; *Woodruff v. McDonald*, 33 Ark. 97.

ber of persons agreed to take shares, and authorized the parties soliciting the subscriptions to write their names and the amounts taken upon slips of paper. The subscriptions thus obtained were afterwards transcribed by an officer of the company upon the stock-book. The court held that this book was the primary evidence of the subscriptions. Beck, J., said: "The book and slips of paper upon which the names and amounts were written at the meeting were but memoranda of the authority conferred upon the officer of the company to make subscriptions in the name of the different parties agreeing to take stock in the corporation. The book admitted in evidence thus became the original contract or subscription, and was properly admitted without proof of the loss, as claimed by defendant."

Under an act providing that each subscriber to the articles shall subscribe thereto "his name, place of residence, and amount by him subscribed," a subscription in a partnership name is valid, and the members of the firm are jointly liable.¹

It has been held that a subscription given in escrow to the commissioners authorized to receive it is binding unconditionally from delivery.²

§ 70. **Allotment of Shares.**—If the constitution of a company requires an allotment of shares before an applicant can become a member, the contract between the applicant and the other shareholders in the company does not become binding until after an allotment has been made, and notice thereof sent to the applicant.

This is the rule in England under the Companies Act of 1862. An application for shares is a mere offer, which does not become binding as a contract until an allotment is made to the applicant by the directors of the company. The application may therefore be revoked at any time before it has been accepted.³

¹ Ogdensburgh, &c. R. R. Co. v. 16 B. Monr. 4. Compare Cass v. Frost, 21 Barb. 541. Compare Troy, Pittsburg, &c. Ry. Co., 80 Pa. St. &c. R. R. Co. v. Warren, 18 Barb. 31.

² Ward's Case, L. R. 10 Eq. 659;

³ Wight v. Shelby R. R. Co., Best's Case, 2 De G., J. & S. 650;

But an allotment is not necessary to conclude an agreement to become a shareholder in the company when shares shall be allotted; it is only necessary in order to constitute the applicant a present shareholder in the company.¹

The offer of an applicant for shares will be deemed open for acceptance only for a reasonable length of time.² The acceptance of this offer requires both an allotment and notice thereof to the applicant. An allotment without notice is not sufficient.³ The notice may be sent by post, and the allottee becomes bound from the time of posting the notice.⁴ If the allottee in fact knew of the allotment, a formal notification may be dispensed with.⁵

It is evident that an allotment of shares must be made in strict conformity with the application;⁶ and where the application is made conditionally, or upon special terms, a plain acceptance of the conditions or special terms is necessary.⁷

Under the Companies Act of 1862 the original subscribers of the memorandum are, by the twenty-third section of the act, to be deemed to have agreed to become members, and must be entered upon the register of shareholders. They must be treated as shareholders, although no shares have been allotted to them, and although they have never been

Ramsgate, &c. Co. v. Montefiore, L. R. 1 Ex. 109; Chapman's Case, L. R. 2 Eq. 567; Ritso's Case, L. R. 4 Ch. D. 774.

¹ Adams's Case, L. R. 13 Eq. 474; compare *supra*, § 61

² Ramsgate, &c. Co. v. Montefiore, L. R. 1 Ex. 109; Bailey's Case, L. R. 5 Eq. 428, and 3 Ch. App. 592.

³ Hebb's Case, L. R. 4 Eq. 9; Gunn's Case, L. R. 3 Ch. App. 40; Crawley's Case, L. R. 4 Ch. 322; Wallis's Case, Id. 325, note; Pellatt's Case, L. R. 2 Ch. 528; Ward's Case, L. R. 10 Eq. 659.

⁴ Harris's Case, L. R. 7 Ch. 587. Compare Hebb's Case, L. R. 4 Eq. 9; British & Amer. Tel. Co. v. Col-

son, L. R. 6 Ex. 108; and see Townsend's Case, L. R. 13 Eq. 148.

⁵ Levita's Case, L. R. 3 Ch. 36; Crawley's Case, L. R. 4 Ch. 322; Richards v. Home Assur. Ass., L. R. 6 C. P. 591. Compare Pellatt's Case, L. R. 2 Ch. 527.

⁶ Gustard's Case, L. R. 8 Eq. 438; Roberts's Case, 1 Drew. 204; Jackson v. Turquand, L. R. 4 H. L. 305; Oriental, &c. Steam Co. v. Briggs, 4 De G., F. & J. 191; Duke v. Andrews, 2 Exch. 290. Compare Harris's Case, L. R. 7 Ch. App. 587.

⁷ Shackelford's Case, L. R. 1 Ch. App. 567; Rogers's Case, L. R. 3 Ch. App. 633. See also Lindley on Partnership (4th ed.), 100-106.

registered as shareholders.¹ But if all the shares in the company have been duly allotted to other persons, so that none are left which a subscriber of the memorandum can be treated as holding, he must be treated as having transferred his shares.²

§ 71. **When Payment of Deposit is essential to the Validity of a Subscription.** — Charters and general incorporation laws, in many instances, have provided that the subscribers for shares in a company formed under them shall make a certain deposit in money for each share subscribed. In construing some of the statutes containing provisions of this description, it has been held that the payment of the deposit was required for purposes of general public policy, as a safeguard against fictitious and fraudulent subscriptions, and to insure to creditors a portion, at least, of the security they were entitled to expect.³ In these cases, therefore, it was considered that actual payment of the deposit upon the prescribed portion of the capital of the corporation was intended as a condition precedent to the right of the company to exercise corporate powers at all,⁴ and that a subscription made without the payment of the deposit must be treated as absolutely null and void.⁵

¹ *Re London, &c. Coal Co.*, L. R. 5 Ch. D. 525; *Hall's Case*, L. R. 5 Ch. App. 707; *Evans's Case*, L. R. 2 Ch. App. 427; *Sidney's Case*, L. R. 13 Eq. 228.

² *Mackley's Case*, L. R. 1 Ch. D. 247; *Drummond's Case*, L. R. 4 Ch. App. 772, 776; and see *Lindley on Partnership* (4th ed.), 1338.

³ As to the rights of the creditors of a corporation, see *infra*, Chapter X.

⁴ *People v. Chambers*, 42 Cal. 201, *supra*, § 30. Compare *Napier v. Poe*, 12 Ga. 170, 184; *Commonwealth v. West Chester R. R. Co.*, 3 Grant's Cas. 200.

⁵ *Jenkins v. Union Turnpike Co.*, 1 Caines Cas. 86; *Excelsior Grain Binder Co. v. Stayner*, 25 Hun, 91;

s. c. 58 How. Pr. 273. Compare *Goshen Turnpike Co. v. Hurtin*, 9 Johns. 218; *Highland Turnpike Co. v. McKean*, 11 Johns. 98; *Ogdensburgh, &c. R. R. Co. v. Wolley*, 34 How. Pr. 65; *Ogdensburgh, &c. R. R. Co. v. Frost*, 21 Barb. 542. See also *State Insurance Co. v. Redmond*, 1 McCrary C. C. 308; *Fiser v. Mississippi & Tenn. R. R. Co.*, 32 Miss. 359; *Taggart v. Western Md. R. R. Co.*, 24 Md. 588, 592; *Busey v. Hooper*, 35 Md. 15; *Charlotte, &c. R. R. Co. v. Blakely*, 3 Strobb. 245; *Wood v. Coosa, &c. R. R. Co.*, 32 Ga. 273; *Hibernia Turnpike Co. v. Henderson*, 8 S. & R. 219; *Bucher v. Dillsburg, &c. R. R. Co.*, 76 Pa. St. 306, *per Sharswood and Williams, JJ.*; *Boyd v. Peach Bottom Ry. Co.*,

But even where this construction has been placed on a statute, the payment must not necessarily be made at the outset. If made at a subsequent time, it will inure to the benefit of the subscriber, and his contract will become valid, and binding.¹ Under a law requiring a payment of a certain percentage to be made upon each subscription in *cash* or *money*, a payment by promissory note,² or by check,³ is not sufficient until the note or check has actually been paid. Hence it has been held, that, where a subscriber gives his check for the required ten per cent, but countermanded the check before it was presented for payment, his subscription would never become binding.⁴ If, however, a company should negotiate a note or check received in payment of a required deposit, and thus obtain the amount in money, this would probably be considered a sufficient payment to satisfy the statute. In *Beach v. Smith*,⁵ the defendant, after having subscribed for shares, presented an account against the company for services, and credited the company with the amount which the statute required to be paid on making the subscription. The account was allowed by the company, and a balance due the defendant was paid. It was held that this was a sufficient compliance with a statute requiring payment to be made in cash on subscribing, to render the defendant's subscription binding.

Under a statute providing that the articles of association of a proposed railroad company "shall not be filed . . . until

90 Pa. St. 169; and compare *Commonwealth v. West Chester R. R. Co.*, 3 Grant's Cas. 200; *Garrett v. Dillsburg, &c. R. R. Co.*, 78 Pa. St. 465; *Philadelphia & W. C. R. R. Co. v. Hickman*, 28 Pa. St. 318.

¹ *Black River, &c. R. R. Co. v. Clarke*, 25 N. Y. 203; *Beach v. Smith*, 30 N. Y. 116; 28 Barb. 258. See also *Fiser v. Mississippi & Tenn. R. R. Co.*, 32 Miss. 359; *Barrington v. Mississippi Central R. R. Co.*, Id. 370; *Klein v. Alton, &c. R. R. Co.*, 13 Ill. 514; *Hall v. Selma, &c. R. R. Co.*, 6 Ala. 742.

² *Leighty v. Susquehanna, &c. Turnp. Co.*, 14 S. & R. 434; *Boyd v. Peach Bottom Ry. Co.*, 90 Pa. St. 169.

³ *Excelsior Grain Binder Co. v. Stayner*, 25 Hun, 91. Compare *People v. Stockton, &c. R. R. Co.*, 45 Cal. 306; *Thorp v. Woodhull*, 1 Sandf. Ch. 411.

⁴ *Excelsior Grain Binder Co. v. Stayner*, 61 How. Pr. 456; s. c. 25 Hun, 91.

⁵ *Beach v. Smith*, 30 N. Y. 116; 28 Barb. 258. Compare *People v. Troy House Co.*, 44 Barb. 626, 634.

at least \$1,000 of stock for every mile of the road proposed to be made is subscribed thereto, and ten per cent paid thereon in good faith, in cash, to the directors named in said articles of association," it is not necessary that ten per cent be paid on each subscription, but it is sufficient if the cash payments, by whomsoever made, amount in the aggregate to ten per cent of one thousand dollars for each mile of road.¹

§ 72. **When Payment of Deposit is not essential.**— In other cases, however, it has been held that a provision in an act of incorporation, requiring the payment of a deposit upon each share subscribed, did not impose a condition precedent to the incorporation of the company, but that it was intended solely for the benefit of the company and its creditors, and for the purpose of providing a fund out of which the expenses of the preliminary organization might be paid. Under a law of this character, a subscription made without the payment of the deposit would not be void. It might be refused by the other subscribers, or the corporation acting on their behalf, on account of the non-performance of a condition upon which membership was offered; but if the corporation should accept the subscription without the payment of the deposit, the subscriber would not be entitled to deny the validity of his contract.

There are strong arguments in favor of this view. To permit subscribers to repudiate their subscriptions after the company has been organized, on the ground that they neglected to pay the prescribed deposit, would in many instances defeat the very purposes for which the statute was enacted. The subscribers would commit a fraud upon the State by forming and organizing a corporation on the strength of worthless subscriptions; they would be guilty of a fraud upon other subscribers, by inducing them to take shares on the faith of the genuineness of their subscriptions, and they would be guilty of a fraud upon creditors by obtaining credit on fictitious capital stock.²

¹ *Lake Ontario, &c. R. R. Co. v. Mason*, 16 N. Y. 451; *Spartanburg, &c. R. R. Co. v. Ezell*, 14 S. Car. 281.

² In *Illinois River R. R. Co. v. Zimmer*, 20 Ill. 654, 657, Caton, C. J., said: "Good faith to other subscribers, who may have been in-

In *Mitchell v. Rome R. R. Co.*,¹ the charter of the railroad company contained a provision that, "upon the subscription for shares in said stock, the subscribers shall pay the sum of five dollars on each share subscribed for by such subscriber; provided that said company may commence the construction of their railroad and boating so soon as three thousand shares shall be subscribed;" and it was held by the Supreme Court of Georgia that the payment of five dollars on each share at the time of subscription was not a condition precedent either to the existence of the company as a corporation, or to its right to commence business, and that a failure to pay did not render the subscription void.²

Upon the same principle, it was held in New Hampshire that, where the by-laws of a corporation provided that "ten per cent shall be payable upon subscription, or the subscription shall be void," a subscription made without the required payment was at most only voidable, at the election of the corporation, and if accepted by the company was binding upon the subscriber.³

§ 73. **Irregular Contracts of Membership.**—A failure to comply with the forms prescribed by law in entering into

duced to take stock on the strength of these very subscriptions, requires that the defendants shall go on with them in the execution of the enterprise. Good faith to the creditors of the company, who had a right to look to the list of subscribers to determine whether the company was worthy of credit, imperiously demands that those who by their subscriptions induced the credit shall be compelled to contribute to the fund from which they are to receive their pay." Compare *Garrett v. Dillsburg, &c. R. R. Co.*, 78 Pa. St. 465.

¹ *Mitchell v. Rome R. R. Co.*, 17 Ga. 574. Compare *Wood v. Coosa, &c. R. R. Co.*, 32 Ga. 273.

² See also *Illinois River R. R. Co. v. Zimmer*, 20 Ill. 656; Ver-

mont *Central R. R. Co. v. Clayes*, 21 Vt. 30; *Smith v. Tallassee, &c. Plank Road Co.*, 30 Ala. 650; *Wight v. Shelby R. R. Co.*, 16 B. Monr. 4; *Vicksburg, &c. R. R. Co. v. McKean*, 12 La. Ann. 638; *Henry v. Vermillion, &c. R. R. Co.*, 17 Ohio, 191; *Chamberlain v. Painesville, &c. R. R. Co.*, 15 Ohio St. 225. Compare *Napier v. Poe*, 12 Ga. 170, 184; *Ryder v. Alton & Sangamon R. R. Co.*, 13 Ill. 516; *Klein v. Alton & Sangamon R. R. Co.*, Id. 514; *Commonwealth v. West Chester R. R. Co.*, 3 Grant's Cas. 200; *Ogdensburgh, &c. R. R. Co. v. Wolley*, 34 How. Pr. 54; *Home Stock Ins. Co. v. Sherwood*, 72 Mo. 461.

³ *Piscataqua Ferry Co. v. Jones*, 39 N. H. 491.

the contract of membership does not necessarily prevent a person from becoming a shareholder *de facto*, with all the rights and liabilities of a shareholder. The authority of the ordinary agents receiving subscriptions for shares, on behalf of the corporation or the other shareholders, is undoubtedly limited by the prescribed conditions, and any irregular contract would be contrary to the implied prohibition of the law. But the want of authority in the agent may be cured by the subsequent act of the principal, and the legal prohibition does not necessarily render the contract null and void. The mutual relationship existing between the shareholders in a corporation, and the equitable rights of creditors, must be considered. It is an established rule of general application, that a person who has been recognized as a shareholder, and has acted as a shareholder, will be held liable as a shareholder both to the company and its creditors.¹

§ 74. **Proof of Membership.**—Evidence that a person subscribed for shares in a corporation before it had been fully incorporated, would not be sufficient to establish that he became a shareholder, in the absence of proof that all conditions precedent to the incorporation of the company have been performed.² Evidence that a subscription was made after the organization of the company, and that it was accepted by the proper agents, would, however, be sufficient.³ In order to establish that a person became a shareholder in a corporation, it must, of course, be made to appear that the company had a capital stock, and that it had the power to issue the shares.⁴

Proof of facts or circumstances which would constitute a person a shareholder, or which would estop a person from denying that he became a shareholder, would clearly be sufficient evidence of membership. Hence it would ordinarily be sufficient, in a suit to charge a defendant as a share-

¹ *Infra*, §§ 721, 723, 728.

³ *Supra*, §§ 60, 61.

² *Supra*, § 67. *Infra*, § 717.

⁴ *Minneapolis Harvester Works v. Libby*, 24 Minn. 327. Compare *Cheraw, &c. R. R. Co. v. White*, 14 S. C. 51; *Same v. Garland*, 14 S. C. 63.

holder, to prove that he has acted as a stockholder, and that he was received as a shareholder by the company.¹

It should be observed, however, that the liability of shareholders to contribute the amount of their shares may frequently depend upon conditions precedent. In a suit to enforce the liability of a shareholder to contribute the amount of his shares, it is not only necessary to show that he became a shareholder, but it must also be shown that all conditions precedent to his liability have been fulfilled.²

§ 75. **Stock-Books admissible as Evidence for the Company.**—It has been held that the books of a corporation are admissible in evidence to prove that all things necessary to the legal incorporation and organization of the company have been performed,³ and that the commissioner's book of subscriptions is *prima facie* evidence that the subscriptions were genuine, and made by persons duly authorized.⁴ "Where the name of an individual appears on the stock-book of a corporation as a stockholder, the *prima facie* presumption is that he is the owner of the stock, in a case where there is nothing to rebut that presumption; and, in an action against him as a stockholder, the burden of proving that he is not a stockholder, or of rebutting that presumption, is cast upon the defendant."⁵ Where a certain amount of stock must be

¹ *Infra*, § 721. The admissions of a defendant are sufficient *prima facie* evidence that he became a shareholder. *Dows v. Naper*, 91 Ill. 44. The authenticity of subscriptions may be established by proof that calls made upon the subscribers have been paid. *Union Hotel Co. v. Hersee*, 79 N. Y. 454, 460.

² *Infra*, §§ 136-146.

³ *Grant v. Henry Clay Coal Co.*, 80 Pa. St. 208; *Wood v. Jefferson Co. Bank*, 9 Cow. 194; *Penobscot, &c. R. R. Co. v. Dunn*, 39 Me. 587, 596; *Ryder v. Alton, &c. R. R. Co.*, 13 Ill. 516, 523; *Duke v. Cahawba Nav. Co.*, 10 Ala. 82; *Hall*

v. Carey, 5 Ga. 239, and cases in following notes. See also *supra*, §§ 40-42.

⁴ *Rockville, &c. Turnpike Co. v. Van Ness*, 2 Cranch C. C., 449, 451.

⁵ *Turnbull v. Payson*, 95 U. S. 421, *per* Justice Clifford, citing *Hoagland v. Bell*, 36 Barb. 57; *Hamilton, &c. Plank Road v. Rice*, 7 Barb. 162; *Rockville, &c. Turnpike Co. v. Van Ness*, 2 Cranch C. C. 449, 451; *Mudgett v. Horrell*, 33 Cal. 25; *Coffin v. Collins*, 17 Me. 440; *Merrill v. Walker*, 24 Me. 237; *Hammond v. Straus*, 53 Md. 1, 16; *Pittsburgh, &c. R. R. Co. v. Applegate*, 21 W. Va. 172. See also

subscribed before a shareholder can be required to pay assessments, the stock-books are *prima facie* evidence that the required amount has been subscribed.¹

The stock-books are not merely received in evidence as explanatory entries made contemporaneously with the transaction which they record, but they are admitted as independent evidence. It has been held that a stock ledger and shareholders' list were admissible to prove who were the stockholders of a company, although compiled by copying the original subscription paper which had been circulated and signed.²

§ 76. While the rule stated in the preceding section appears to be well established by authority, it is difficult to support it by any principle of the common law. The stock-books of a corporation are undoubtedly evidence against it, as admissions; but they cannot be admitted on this ground for the company, against a person who denies that he is a shareholder.³

In England, by the Companies Clauses Consolidation Act of 8 & 9 Vict. c. 17, § 29, the register of shareholders was expressly made *prima facie* evidence that a person whose name was on the books was a shareholder, and of the amount and number of his shares. In an action brought by a company to recover calls, Lord Brougham said: "A great privilege is bestowed by the act upon the company, neither more nor less than that of making evidence for itself. The books of the company are made evidence for the company, and, unless

Wood v. Coosa, &c. R. R. Co., 32 Ga. 273.

The fact that the stock-books show a transfer to the defendant, and no subsequent re-transfer, is *prima facie* evidence that the defendant is still a stockholder. Tilden v. Young, 39 Mich. 58.

¹ Penobscot R. R. Co. v. Dummer, 40 Me. 172; Penobscot R. R. Co. v. White, 41 Me. 512; Lane v. Brainerd, 30 Conn. 565; Marlborough, &c. R. R. Co. v. Arnold,

9 Gray, 159; Central Turnpike Co. v. Valentine, 10 Pick. 142. *Contra*, Philadelphia, &c. R. R. Co. v. Hickman, 28 Pa. St. 318; and compare Chase v. Sycamore, &c. R. R. Co., 38 Ill. 215, 218.

² Stuart v. Valley R. R. Co., 32 Gratt. 146; Hayden v. Atlanta Cotton Factory, 61 Ga. 234.

³ See Wheeler v. Walker, 45 N. H. 355, 358; Chase v. Sycamore, &c. R. R. Co., 38 Ill. 215, 218; Wharton on Evidence, § 661.

rebutted by counter evidence, will be sufficient to warrant a verdict in each case. It must be admitted that this is a very great privilege, and an exception to the ordinary rules of evidence. By those rules, and the rules of common sense and justice, what a man writes is evidence against him, but not evidence in his favor; but here the proposition is reversed. So that the company, by writing in the books that 'A. B. holds' a certain number of shares, can go into court and make A. B. answerable for them, and can produce the entry as evidence against him. This is a great privilege, and, in order to justify the exercise of it, the conditions on which it is given, namely, the provisions of the statute as to the making of these entries, must be strictly complied with; and I hold that it is much safer to consider each of those provisions as a condition precedent, as a condition imperative, and not merely directory, on account of the great importance of the privilege itself, and on account of its being an exception to all ordinary rules of evidence."¹

§ 77. **Subscriptions are Contracts in Writing.**—A subscription for shares in a corporation is a contract in writing, and therefore cannot be proven by parol evidence until the absence of the original has been accounted for.² Nor can the terms of the contract entered into by a subscriber be varied by parol evidence of a special agreement or condition made prior to or contemporaneous with the subscription.³

¹ *Bain v. Whitehaven, &c. Ry. Co.*, 3 H. L. C. 1, 22. See also *Birkenhead, &c. Ry. Co. v. Brownrigg*, 4 Exch. 426.

² *Vreeland v. N. J. Stone Co.*, 29 N. J. Eq. 188, 191; *Pittsburgh, &c. R. R. Co. v. Gazzam*, 32 Pa. St. 340; *Pittsburgh, &c. R. R. Co. v. Clarke*, 29 Pa. St. 146, 152; *Fairfield County Turnpike Co. v. Thorp*, 13 Conn. 173. The erasure or alteration of a subscription does not *per se* prevent a suit upon it. Explanatory parol evidence is admissible. *Johnson v. Wabash, &c. Plank Road Co.*, 16 Ind. 389; *Sodus Bay, &c. R. R. Co.*

v. Hamlin, 24 Hun, 390; *Greer v. Chartiers Ry. Co.*, 96 Pa. St. 391.

³ *McClure v. People's Freight Ry. Co.*, 90 Pa. St. 271; *Mississippi, &c. R. R. Co. v. Cross*, 20 Ark. 443; *Piscataqua Ferry Co. v. Jones*, 39 N. H. 491; *Wight v. Shelby R. R. Co.*, 16 B. Monr. 4; *Connecticut, &c. R. R. Co. v. Bailey*, 24 Vt. 465; *Methodist Episcopal Church v. Town*, 49 Vt. 29; *New Albany, &c. R. R. Co. v. Fields*, 10 Ind. 187; *Evansville, &c. R. R. Co. v. Posey*, 12 Ind. 363; *Eakright v. Logansport, &c. R. R. Co.* 13 Ind. 404, 407; *Roche v. Roanoke Seminary*, 56 Ind. 198;

PART II.

SUBSCRIPTIONS UPON CONDITIONS PRECEDENT AND UPON SPECIAL TERMS.

§ 78. **Subscriptions upon Conditions Precedent.**—A subscription for shares may, by its express terms, be made contingent in its operation upon the performance of certain conditions precedent. In this case the subscriber does not become a shareholder in the corporation, together with those who subscribed unconditionally; but his subscription is merely an *offer* to become a shareholder after the prescribed conditions have been performed. The performance of the stipulated conditions is necessary to an acceptance of the offer to become a shareholder; and before the conditions have been performed the subscriber does not, by virtue of his subscription, become a member of the company at all. It follows, that he does not, until then, become entitled to the privileges nor subject to any of the liabilities attaching to the status of a shareholder.

Thus, in *Ticonic Water Power Co. v. Lang*,¹ it appeared that the defendant had subscribed for shares upon condition “that \$75,000 be subscribed for before June 14, 1867.” The full amount was subscribed within the time stipulated, but a considerable portion of the subscriptions were made upon condition that the balance of the shares should be taken “by citizens of Waterville and Winslow.” This latter condition was not fulfilled. The Supreme Court of Maine held that the defendant was not liable, because there was not, on June 14, 1867, a binding subscription of \$75,000, as required by the

Haskell v. Sells, 14 Mo. App. 91; White Hall, &c. R. R. Co. v. Myers, Smith v. Tallassee, &c. Plank Road 16 Abb. Pr. n. s. 34; Noble v. Calender, 20 Ohio St. 199. Compare R. R. Co. v. Leach, 4 Jones (Law), Tonica, &c. R. R. Co. v. Stein, 21 340; Thigpen v. Mississippi Cent. Ill. 96. R. R. Co., 32 Miss. 347; Ridgefield, ¹ Ticonic Water Power Co. v. &c. R. R. Co. v. Brush, 43 Conn. 98; Lang, 63 Me. 480.

terms of his subscription. Danforth, J., said: "Whatever might be the condition of the stock-book subsequent to June 14, 1867, at that time the conditions upon which the defendants subscribed had not been fulfilled, their proposition to take stock had not been accepted, and they were released from any obligation which before that might have rested upon them. After such release their obligation could not be restored by any act of the other parties to the contract without their consent."¹

§ 79. **Condition as to Location of a Railroad.**—Upon the same principle, it has been decided that, if a subscription for shares in a railroad company is made upon the condition that the road shall *be located* upon a certain route, the subscriber does not become a shareholder, or incur any liability upon his subscription, until the road has been located in accordance with the terms of his offer; but if the road is located by the corporation in the manner required, before the offer is withdrawn, the subscriber will become bound as a member of the company, and invested with all the rights and obligations attaching to that position.²

In *McMillan v. Maysville, &c. Railroad Co.*,³ the Supreme

¹ See also *Philadelphia, &c. R. R. Co. v. Hickman*, 28 Pa. St. 318; *Cass v. Pittsburg, &c. Ry. Co.*, 80 Pa. St. 31; *Troy, &c. R. R. Co. v. Newton*, 8 Gray, 596; *People's Ferry Co. v. Balch*, 8 Gray, 312; *Cabot, &c. Bridge Co. v. Chapin*, 6 Cush. 53; *Santa Cruz R. R. Co. v. Schwartz*, 53 Cal. 106; *Oskaloosa Agricultural Works v. Parkhurst*, 54 Iowa, 357; *Monadnock R. R. Co. v. Felt*, 52 N. H. 379.

² *Swartout v. Michigan Air Line R. R. Co.*, 24 Mich. 405; *Evansville, &c. R. R. Co. v. Shearer*, 10 Ind. 246; *Jewett v. Lawrenceburgh, &c. R. R. Co.*, 10 Ind. 539; *Taggart v. Western Md. R. R. Co.*, 24 Md. 563; *McMillan v. Maysville, &c. R. R. Co.*, 15 B. Monr. 218, 235. See also *Racine County Bank v. Ayers*, 12

Wis. 512; *Martin v. Pensacola, &c. R. R. Co.*, 8 Fla. 370; *O'Neal v. King, 3 Jones (Law)*, 517; *Wear v. Jacksonville, &c. R. R. Co.*, 24 Ill. 595; *Mansfield, &c. R. R. Co. v. Brown*, 26 Ohio St. 224; *Mansfield, &c. R. R. Co. v. Stout*, Id. 241; *Chamberlain v. Painesville, &c. R. R. Co.*, 15 Ohio St. 225; *Lowe v. E. & K. R. R. Co.*, 1 Head, 659; *North Missouri R. R. Co. v. Winkler*, 29 Mo. 318; *Connecticut, &c. R. R. Co. v. Baxter*, 32 Vt. 805; *Spartanburg, &c. R. R. Co. v. De Graffenried*, 12 Rich. L. 675; *Freeman v. Matlock*, 67 Ind. 99; *Des Moines Valley R. R. Co. v. Graff*, 27 Iowa, 99. See *infra*, § 90.

³ *McMillan v. Maysville, &c. R. R. Co.*, 15 B. Monr. 218, 235, *per Simpson, J.*

Court of Kentucky, in referring to a subscription of this character, said: "The substance of the agreement of the company and the signers of the instrument of writing sued upon was, that, if the former would locate the road so as to make the town of Carlisle a point, the latter would take the amount of stock subscribed by them. When the road was thus located, the signers became unconditional stockholders, and as such were entitled to all the corporate rights and privileges of members of the company. The stock itself was not conditional; it was only the agreement to take it that was conditional. The subscribers were not stockholders until the company had performed the condition upon which their undertaking depended; and when that was done, they became stockholders by force of the agreement of the parties."

In order to fulfil a condition of this character, it is necessary that the line of road be finally located in the statutory manner, but it is not necessary that the road be built and equipped.¹

§ 80. It has been held in New York, that it is contrary to public policy to allow subscriptions to a plank road or turnpike company to be made upon condition that the road be located in a certain line; and that such subscriptions do not constitute the subscribers members of the corporation, although the condition may have been performed. "If the general subscription should contain a condition of this kind, there would be no stockholders till the road should be laid out accordingly; and separate subscriptions containing various conditions might work a fraud upon those who subscribe absolutely."²

This view is contrary to the weight of authority, and has not generally been followed. Subscriptions upon conditions precedent are nowhere regarded as anything more than offers

¹ As to what constitutes the location of a road, see *Evansville, &c. R. R. Co. v. Dunn*, 17 Ind. 603. *Fort Edward, &c. Plank Road Co. v. Payne*, 15 N. Y. 588, overruling 17 Barb. 567. Compare *Holladay v. Patterson*, 5 Oreg. 177, and *Cumberland Valley R. R. Co. v. Baab*, 9

² *Butternuts, &c. Turnpike Co. v. North*, 1 Hill, 518, *per Cowen, J.*; *Watts*, 458.

to become shareholders, or to take shares, when the conditions shall be performed. It is difficult to perceive what fraud or possible injury to others would result from an offer to take shares in a railroad company if the line of road shall be located in a certain way.¹

§ 81. **Effect of Subscriptions upon Conditions Precedent.** — As a subscription for shares in a corporation, made upon condition precedent, is merely an offer to take shares after the condition has been performed, and is not binding on the subscriber as a statutory subscription, it follows that subscriptions of this nature, when made before the incorporation of a company, do not entitle the subscribers to enjoy the corporate franchises offered by the State; it would be a fraud upon the State to obtain letters patent, and organize as a corporation, by representing such conditional subscribers to be members of the association to be incorporated.² It is clear, also, that subscriptions for shares, made upon condition precedent, cannot be counted in determining whether the amount of capital required by law to authorize a corporation to begin to carry on business, and to call on its members for the payment of their shares of the capital, has been subscribed.³ Nor are such conditional subscribers liable as shareholders to the company, or to its creditors, until the conditions upon which they have agreed to become shareholders have been performed.⁴

§ 82. **Subscriptions upon Special Terms.** — Subscriptions which are conditional upon the happening of a future event must not be confounded with subscriptions made subject to special terms or stipulations varying the usual contract of membership. In the former case, the subscribers do not become stockholders until the prescribed condition has been

¹ *McMillan v. Maysville, &c. R. R. Co.*, 15 B. Monr. 218, 235; *Henderson, &c. R. R. Co. v. Leavell*, 16 B. Monr. 358, 364; and cases cited in the preceding sections.

² *Bavington v. Pittsburgh, &c. R. R. Co.*, 34 Pa. St. 358; *Pittsburgh, &c. R. R. Co. v. Biggar, Id.* 455. *Infra*, § 92.

³ *Infra*, § 141. *Oskaloosa Agricultural Works v. Parkhurst*, 54 Iowa, 357.

⁴ *Pitchford v. Davis*, 5 M. & W. 2; *Roberts's Case*, 3 De G. & S. 205; *Wood's Case*, 3 De G. & J. 85; and cases cited in the preceding sections.

fulfilled; but after fulfilment of the condition they become shareholders upon the same terms as other members. In the latter case, the subscribers become shareholders as soon as their subscriptions are accepted by the company, but their rights and liabilities as shareholders are governed by the special terms for which they have stipulated.

Thus, if a subscription for shares in a railroad company is made upon the condition that the road be located upon a certain line, the subscriber does not become a shareholder in the company until the road has been located accordingly.¹ On the other hand, a subscription made subject to a special proviso, that the company shall undertake to build its railroad to a certain point, or that the subscriber shall be entitled to contribute the amount of his shares at a particular time, or in property of a certain kind, may constitute the subscriber a shareholder immediately, if accepted by the corporation, and the proviso of the subscription would merely affect the terms of his contract of membership.² A subscription of this kind is not, properly speaking, a *conditional* subscription; it is an absolute subscription with special or unusual terms, and is similar to a subscription for preferred shares.

§ 83. **Agents before Organization cannot make Special Agreements.**—The agents or commissioners appointed, under a charter or general law, to receive subscriptions to the stock of a corporation about to be formed, have no authority to make special contracts on behalf of the company, with regard to the liability of its members. They are not agents selected by the shareholders themselves, and for the most obvious reasons their powers should not be extended beyond those expressly conferred. They are authorized to receive subscriptions upon the terms expressly or impliedly set forth in the charter or the articles of association and general laws, and their authority extends no further.³ A subscription for shares made upon special terms, prior to the organization of the company, is at most an offer to become a shareholder upon

¹ *McMillan v. Maysville, &c.* R. R. Co., 15 B. Monr. 218, 235; ² *Infra*, §§ 84, 90. ³ *Supra*, § 66.
supra, § 79.

the terms indicated, and this offer can be accepted only by the managing agents of the company after organization.¹

§ 84. **Managing Agents may receive Subscriptions on Special Terms.**—The directors or managing agent of a corporation have a limited power to vary the usual contract of membership by issuing shares upon special terms. If the special agreement is favorable to the company as a body, it is clear that there can be no objection to its validity. Thus, if the contract of membership does not imply a personal obligation to pay assessments, a subscription containing a promise to pay will make the subscriber liable;² and the obligations of a subscriber for shares may be increased in many other respects by the express terms of his contract.³

§ 85. Special agreements by which the liability of shareholders to contribute the amount of their shares has been varied with respect to the time, place, or manner of making the payments, have been sustained. Thus, in *Pittsburgh, &c. R. R. Co. v. Stewart*,⁴ the Supreme Court of Pennsylvania held that a special contract making a subscription to the stock of a railroad company, payable in cross-ties, was valid. Strong, J., said: "It is no longer to be doubted that an incorporated company, after it has obtained its letters patent and effected its organization, may receive conditional subscriptions to its stock. It may stipulate with subscribers that they may pay in any manner mutually agreed on, and it can enforce a subscription only according to its conditions. Not so with subscriptions made before a company is organized. They must be unconditional. There is no authority existing anywhere to receive them upon terms, or to vary the mode of payment. This difference is a well-recognized one in our law, as well as in the law of other States. Clearly,

¹ *Pittsburgh, &c. R. R. Co. v. Stewart*, 41 Pa. St. 54, 58; *Erie, &c. Plank Road Co. v. Brown*, 25 Pa. St. 158; *Trott v. Sarchett*, 10 Ohio St. 241. See *Caley v. Philadelphia, &c. R. R. Co.*, 80 Pa. St. 363; *Bavington v. Pittsburgh, &c. R. R. Co.*, 84 Pa. St. 358; *Pittsburgh, &c. R. R. Co. v. Biggar*, Id. 455; *Syracuse, &c. R. R. Co. v. Gere*, 4 Hun, 392; *Burrows v. Smith*, 10 N. Y. 550, 566. *Supra*, § 47.

² See *infra*, §§ 129, 130.

³ See *infra*, §§ 144, 149.

⁴ *Pittsburgh, &c. R. R. Co. v. Stewart*, 41 Pa. St. 54, 58.

then, the plaintiffs, who were an organized company in November, 1847, with letters patent already obtained, could engage with the defendant, that, if he would hold on to his subscription, or renew it (it having ceased to be binding), he might pay it by furnishing materials for their road, and pay it when the road should be extended to his land. And if the plaintiffs did thus engage, they cannot enforce payment in cash, nor payment before the time appointed.”¹

Where a subscription was by its terms made payable in instalments after twenty days' notice of the calls had been given, it was held that the giving of the notice as stipulated was a condition precedent to liability on the part of the subscriber.²

§ 86. Acceptance of Subscriptions made upon Special Terms before Organization.— A subscription for shares made upon special terms, prior to the organization of a corporation, may be treated as a continuing offer to become a shareholder upon the terms indicated; and if such offer is not withdrawn, it may be accepted by the proper agents of the corporation appointed after its organization, provided the terms of the subscription be of such a nature that the agents of the company have authority to accede to them.

The same rule applies to a subscription on special terms received after organization of the company by an ordinary subscription agent, who would have no authority to bind the company by any special contract. The subscription would be an open offer until accepted by the board of directors.³

It is clear that a subscription made upon special terms must be accepted precisely as offered or not at all. An ac-

¹ See also *Roberts v. Mobile, & Co. v. Reeve*, 15 Ind. 238; *Nichols R. R. Co.* 32 Miss. 373; *Hanover Junction R. R. Co. v. Haldeman*, 82 Pa. St. 36; *Junction R. R. Co. v. Reeve*, 15 Ind. 236; *Magee v. Badger*, 30 Barb. 246.

² *Cole v. Joliet Opera House Co.*, 79 Ill. 96.

³ *Red Wing Hotel Co. v. Friedrich*, 26 Minn. 112; *Junction R. R. Co. v. Burlington, & Plank Road Co.*, 4 Greene (Iowa), 42; *Cass v. Pittsburgh, & Ry. Co.*, 80 Pa. St. 31; *Northern Central, & R. R. Co. v. Eslow*, 40 Mich. 222; and see cases cited in the preceding sections. Compare *Boston, & R. R. Co. v. Bartlett*, 3 Cush. 224.

ceptance varying the terms of the subscription would at most constitute a counter proposition.¹

§ 87. **Special Terms which cannot be accepted.**— Even the managing agents of a corporation have only a very limited authority to make special agreements varying the rights and duties of the several shareholders. This follows from the relationship between the shareholders and the character of their contract. The subscribers for shares have agreed to associate for the purposes and upon the terms expressed in their charter or articles of association. The rights of every shareholder in the management of the company and the distribution of its profits are equal to the rights of every other shareholder in respect of every share; and it is clearly contemplated by the subscribers that the burdens shall be distributed equally also. An agreement giving one subscriber greater privileges, or making his obligations lighter, than those of the other subscribers, would be unfair to those members who had subscribed upon less favorable terms. Hence it is very difficult to imply any authority in the agents of a company to vary the ordinary contract of membership, in any substantial particular, by assenting to a subscription upon special terms. An agreement giving a person the rights of a shareholder, without requiring him to contribute a proportionate amount of capital, would clearly be unauthorized. Such an agreement would be a fraud upon the creditors of the company, as well as upon the other shareholders.²

In *Burke v. Smith*,³ Justice Strong said: “If the subscriptions to the stock can be clogged with such conditions as to render it impossible to collect the fund which the State required to be provided before it would assent to the grant of corporate powers, a charter might be obtained without any available capital. Conditions attached to subscriptions which, if valid, lessen the capital of the company, thus depriving the

¹ *Rogers's Case*, L. R. 3 Ch. App. 397. See also *Syracuse, &c. R. R.* 633; *supra*, §§ 62, 63. *Co. v. Gere*, 4 Hun, 392; *Upton v.*

² *Infra*, §§ 302, 804, 822.

Hansbrough, 3 Biss. 423; and cases

³ *Burke v. Smith*, 16 Wall. 390, cited *infra*, §§ 307, 804.

State of the security it exacted that the railroad would be built, and diminishing the means intended for the protection of creditors, are therefore a fraud upon the grantor of the franchise, and upon those who may become creditors of the corporation. They are also a fraud upon unconditional stockholders who subscribed to the stock in the faith that capital sufficient would be obtained to complete the projected work, and who may be compelled to pay their subscriptions, though the enterprise has failed and their whole investment has been lost. It is for these reasons that such conditions are denied effect."¹

§ 88. **Where all the Subscriptions are upon the same Terms.**—The rule stated in the preceding section has no application where *all* the shareholders in a corporation have subscribed upon the same terms. In this case, it is clear that the terms of the subscriptions cannot result in unfair discrimination against any portion of the shareholders; all have the same rights and liabilities.² Nor can creditors complain even though the entire capital of a corporation be made payable only on the happening of a contingent event; because a corporation is never impliedly authorized to engage in business and incur debts until its capital has become payable,³ and, if debts should be incurred, the special terms of the subscriptions could not be set up against *bona fide* creditors.⁴

The decision in *Ridgefield, &c. R. R. Co. v. Brush*⁵ is in accordance with this view. The charter of a railroad company provided that the corporation might be organized, and proceed to construct its road, whenever \$200,000 had been subscribed, and that the corporators should have authority to open books and receive stock subscriptions, under such regu-

¹ The case of *Hinton v. Morris County Co-operative Soc.*, 21 Kans. 663, cannot be reconciled with these principles. The board of directors of a company had entered into an agreement with a purchaser of shares that he should have the privilege of withdrawing his money at any time, on giving thirty days' notice and

surrendering his shares, and this agreement was sustained.

² The same doctrine has been been applied to an issue of preferred shares. See *infra*, § 440.

³ *Infra*, §§ 137, 403.

⁴ *Infra*, §§ 801-803.

⁵ *Ridgefield, &c. R. R. Co. v. Brush*, 43 Conn. 86, 95.

lations as they might deem proper. Subscription-books were opened, and the subscriptions were all made subject to the terms of a resolution, that no assessment beyond three per cent should be laid until the whole amount estimated to be necessary to complete the road, to wit, \$535,000, had been subscribed. It was held by the Supreme Court of Connecticut that the subscriptions were valid and binding, subject to the terms of the resolution. Carpenter, J., said: "The resolution adopted by the corporators, although it imposed a condition which is not in the charter, nevertheless is not repugnant to the charter, violates none of its provisions, and does not in any sense contravene any principle of law or of public policy. It is simply a declaration in the contract to which *all* the subscribers are parties, and therefore it amounts to an agreement that the corporation will not avail itself of the privilege of commencing the construction of the road until all the necessary funds to complete it are subscribed."

§ 89. **Construction of Subscriptions.** — It is frequently difficult to determine whether a subscription was intended as an agreement to become a shareholder after a condition precedent has been performed, or an agreement to become a shareholder upon special terms.

If it appears that the subscriber intended to become a member of the corporation, and as such entitled to vote at meetings and otherwise enjoy the privileges of membership, it is clear that the subscription cannot be deemed a subscription upon condition precedent.

On the other hand, if a subscription is made subject to a proviso that the liability to pay the amount of a subscription shall be conditional upon the happening of an uncertain event, the subscription would be invalid as a subscription upon special terms; for if it were given effect the subscriber would become a member in the company, and entitled to the attending privileges, while he might never become liable to contribute his proportion of the capital. Hence, subscriptions for shares in a railroad company on condition that the road be located in a certain direction have properly been

construed as subscriptions upon condition precedent;¹ they would be wholly nugatory if intended to constitute the subscriber a member of the company, with the special privilege of not contributing to the capital in case the road should not be located in the direction specified.

§ 90. The intention of the parties is of course the controlling question in construing a subscription for shares, or any other contract. In *Chamberlain v. Painesville, &c. R. R. Co.*,² a subscription for shares in a railroad company upon condition that the road should be *permanently* located on a certain route, and that a freight-house and depot be *built* at a certain place, was construed as an offer on the part of the subscriber to become a shareholder if the company would permanently locate its road in the manner prescribed, *and undertake* to build the freight-house and depot at the place named; and it was held, that, after the corporation had accepted this offer, by locating its road upon the route specified, the subscriber became a member of the company, and, as such, liable to contribute his proportion of the capital, while the provision with regard to building a freight-house and depot remained as a valid executory contract to be performed by the company. The court considered that it was clearly not the intention that the freight-house and depot should be built before the road itself; and that, while the location of the road was a matter to be settled at the outset, and upon which the intention of the subscriber to become a shareholder evidently depended, yet it was not intended that the road should be built and equipped, as well as located, before the subscriber became a shareholder, and liable to contribute the amount of his shares. On the contrary, the main object of the subscription was to raise the capital required for the purpose of building the road and its equipments.³

¹ *Supra*, § 79; and see cases cited in the next section.

² *Chamberlain v. Painesville, &c. R. R. Co.*, 15 Ohio St. 225, 243.

³ See also *Ashtabula, &c. R. R. Co. v. Smith*, 15 Ohio St. 328; *McMillan v. Maysville, &c. R. R. Co.*,

15 B. Monr. 218, 235; *Swartout v. Michigan Air Line R. R. Co.*, 24 Mich. 405; *Miller v. Pittsburgh, &c. R. R. Co.*, 40 Pa. St. 237; *North Missouri R. R. Co. v. Winkler*, 29 Mo. 318; *Wear v. Jacksonville, &c. R. R. Co.*, 24 Ill. 595; *Pittsburgh,*

Upon the same principle, it was held that, although a subscription for shares in a hotel company was expressed to be on condition that the hotel be built at a certain point, the building of the hotel was not a condition precedent to the subscriber's liability to contribute the amount of his shares.¹

In *Jewett v. Lawrenceburgh, &c. R. R. Co.*,² the subscription was on condition that the road should be located and constructed to a certain point. The road was located to the required point, and the subscriber then paid the amount of his subscription. Afterwards, a different location was adopted, and the road was not constructed to the point named in the subscription paper. In a suit brought by the subscriber against the company, the court held that the plaintiff was entitled to recover from the company the amount which he had paid on his subscription.

§ 91. **When the Conditions or Special Terms of a Subscription must be disregarded.** — A person who has subscribed for shares upon condition precedent may supersede his conditional offer by an absolute and unconditional subscription without making a new entry upon the books. This would not, properly speaking, be a mere waiver of the condition of the subscription. The subscriber would practically reaffirm the subscription as a new and unconditional one, and an absolute contract of membership would result in place of a naked offer.

Thus, if a conditional subscriber should subsequently give promissory notes or cash to the company, in payment of the amount of his shares, this would evidently indicate an intention to become a shareholder immediately, irrespective of the condition.³

&c. R. R. Co. *v.* Biggar, 34 Pa. St. 459. Compare *Jewett v. Lawrenceburgh, &c. R. R. Co.*, 10 Ind. 539; *O'Neal v. King*, 3 Jones (Law), 517; *Burlington, &c. R. R. Co. v. Boestler*, 15 Iowa, 555; *Milwaukee, &c. R. R. Co. v. Field*, 12 Wis. 341; *Lane v. Brainerd*, 30 Conn. 578; *Shaffner v. Jeffries*, 18 Mo. 512; *Roberts v. Mobile, &c. R. R. Co.*, 32 Miss. 373.
¹ *Red Wing Hotel Co. v. Friedrich*, 26 Minn. 112.
² *Jewett v. Lawrenceburgh, &c. R. R. Co.*, 10 Ind. 539.
³ *O'Donald v. Evansville, &c. R. R. Co.*, 14 Ind. 259; *Evansville, &c. R. R. Co. v. Dunn*, 17 Ind. 603;

§ 92. A person cannot have the benefits of membership in a corporation without bearing its burdens also. If a person undertakes to *act* as a member, he thereby assumes the liabilities incidental to membership, both with regard to the other shareholders¹ and the creditors of the company;² and it will be no defence to say, that he has subscribed for shares upon a condition precedent, and that the condition has not been performed; or that his subscription was expressed to be upon special terms, and was not accepted by the company, either by reason of the want of power or the want of assent of its agents. The subscription may, in such case, go for nothing; but the subscriber will be treated as a shareholder, by reason of his subsequent acts and the tacit consent of the company; and it is clear that he cannot, under these circumstances, claim the benefit of any conditions or special terms which his original subscription may have contained.³

In *Bavington v. Pittsburgh, &c. R. R. Co.*,⁴ it appeared that a commissioner appointed to receive subscriptions to the stock of a railroad company had himself subscribed for a number of shares, upon condition that the road be located upon a certain route. He afterwards certified to the Governor that the subscriptions, including his own, were taken in good faith, agreeably to the laws of the Commonwealth; and upon the faith of this certificate letters patent were issued and the corporation was organized. The Supreme Court of Pennsylvania decided that the subscriber was estopped from denying that the subscription was an unconditional one; for, if it were a subscription upon condition, the subscriber would have been guilty of a fraud upon the Commonwealth.

§ 93. The same principle applies where subscriptions are made, upon special terms, for the purpose of obtaining

Keller v. Johnson, 11 Ind. 337;
Parks v. Evansville, &c. R. R. Co.,
 23 Ind. 567; *Slipher v. Earhart*,
 83 Ind. 173. Compare *Parker v.*
Thomas, 19 Ind. 214, 220; *Taylor*
v. Fletcher, 15 Ind. 80.

¹ See *infra*, §§ 303, 308.

² *Infra*, §§ 824, 835.

³ See *Burke v. Smith*, 16 Wall.
 397; *Syracuse, &c. R. R. Co. v.*
Gere, 4 Hun, 392; *Dayton, &c.*
R. R. Co. v. Hatch, 1 Disney,
 97; *Lane v. Brainerd*, 30 Conn.
 579.

⁴ *Bavington v. Pittsburgh, &c.*
R. R. Co., 34 Pa. St. 358.

letters patent and organizing upon the strength of them. Inasmuch as the statutory agents have no authority to receive such subscriptions, they must be treated as a nullity, or the special terms must be disregarded. It has been held that, where such subscriptions are made with the intention of obtaining a patent and organizing a corporation upon the faith of them, *and a patent is actually obtained*, the subscription must be held binding, though the special terms be denied effect. In *Pittsburgh, &c. R. R. Co. v. Biggar*,¹ the defendant had subscribed upon condition "that the road goes within half a mile of Florence," and had paid the required deposit of five dollars on each share. It was held that he was liable to pay assessments levied upon his shares. Strong, J., said: "The law offers to the subscriber membership and stock, as the consideration for his subscription, and it offers no more. If he could secure more, it would be a wrong to the other subscribers, not less than if the stipulation were that he should have a certificate for two shares *of stock* on payment for one. The rights of all subscribers are necessarily equal; nor can there be any such thing as conditional membership; either the defendant in error became a corporator on the issuing of the letters patent, by virtue of his subscription, and the payment of five dollars for each, or the subscription amounted to nothing. . . . Was, then, the subscription a nullity? Certainly it was operative for some purposes. It enabled the commissioners to receive and to retain five dollars paid upon each share subscribed, and it aided in obtaining the letters patent. On the faith of it the Commonwealth parted with the franchise conferred upon the company. If such subscriptions, with such conditions, are invalid, then the whole capital of a company might be withheld, even after charter granted, and the objects of the grant entirely defeated. It is not for the defendant to say that his subscription is a nullity; that he assumed no liability, when his act induced the grant of the charter, and fastened upon his co-corporators the obligation to pay the amount of their subscriptions. It is the condition of the subscription which

¹ *Pittsburgh, &c. R. R. Co. v. Biggar*, 34 Pa. St. 455.

is the illegal part ; it is that which is repugnant to the nature of a subscription, and which is in conflict with the policy of the law, and therefore the defendant cannot assert it.”¹

It seems clear, however, that if a subscription was made subject to special terms, or upon condition precedent, with the intention that it should not go into effect or be used until the terms had been accepted or the condition performed by the company after organization, it would be impossible to hold the subscriber liable as if he had subscribed absolutely, or upon the usual terms, except, by making a contract between the parties where none was intended by themselves. If the subscriber should act as a shareholder before the subscription had gone into effect according to its terms, he would become a shareholder by virtue of his acts, and not by virtue of the original subscription.

PART III.

SUBSCRIPTIONS OBTAINED BY FRAUD.

§ 94. **Subscriptions obtained by Fraud are voidable.**— It is a general rule of law, that, if a person is induced to enter into a contract by false representations, fraudulently made by the other contracting party or his agent, the contract is

¹ 34 Pa. St. 459. The learned judge added: “At most, also, the stipulation in the contract of subscription was a condition subsequent; certainly subsequent to membership in the company, and subsequent also to the liability to pay. The thing provided for could only be determined after the organization of the company. The words of the condition show this. The defendant promised to pay ‘provided the road goes within half a mile of Florence.’ The payment of the subscriptions was necessary to en-

able the road to go anywhere; no other means was provided for either the location or construction of the road; payment was therefore necessarily antecedent to a compliance with the condition. But if it is a condition subsequent, and illegal, as we have endeavored to show, then it is void, and the subscription is in law absolute.” See also *Syracuse, &c. R. R. Co. v. Gere*, 4 Hun, 392; *Bedford R. R. Co. v. Bowser*, 48 Pa. St. 29, 37; *Boyd v. Peach Bottom Ry. Co.*, 90 Pa. St. 169.

voidable at the option of the innocent party. This rule applies with full force both to contracts of membership and to contracts to purchase or to take shares in a corporation at a future time. It may be stated as a general rule, that, if a subscription for shares was obtained by fraudulent representations, it may be annulled by the subscriber at any time before other equities have intervened. Lord Romilly said, in considering the right of a person to be relieved of shares which he had taken upon the faith of a fraudulent prospectus issued by the company: "Contracts of this description between an individual and a company, so far as misrepresentation or suppression of the truth is concerned, are to be treated like contracts between any two individuals. If one man makes a false statement which misleads another, the way in which that is to be treated affords the example for the way in which a contract is to be treated where a company makes a false statement which misleads an individual."¹

It is important, however, in considering the effect of fraud upon the contract of membership in a corporation, to bear in mind the peculiar character of this contract, and the equitable relations which it creates as between the shareholders and creditors, and between the shareholders themselves.²

§ 95. **Representations concerning Matters of Public Law.** — A contract is not rendered voidable by a false representation, unless it be a representation of facts which the party imposed upon was not under an obligation to learn for himself. Every person must at his peril acquaint himself with the general laws of the land. Hence it follows that false representations as to matters of public law do not vitiate the contract of a subscriber.

Accordingly, it was held to be no defence to an action upon notes given to a railroad company, in payment of a

¹ *Central Ry. Co. v. Kisch*, L. R. 2 H. L. 99, 125; *Vreeland v. N. J. Stone Co.*, 29 N. J. Eq. 190; *Upton v. Englehart*, 3 Dill. 499; *City Bank v. Bartlett*, 71 Ga. 797, 808. See an essay entitled "Effect of Fraud on Subscriptions to Stock," in the *American Law Rev.*, March, 1880, Vol. XIV. p. 177.

² As to the rights of creditors, see *infra*, § 819, Chapter X.

subscription for shares, that the company has fraudulently represented that it had a right to construct a line of road between two given points. The court said: "That representation was upon matter of law. Whether the company had such right depended upon its charter, which was a public law, and of which the defendant was bound to take notice."¹

§ 96. **Representations with Regard to the Contract of the Subscriber.** — For the same reasons, it follows that false representations as to the legal effect of a subscription for shares in a corporation, or as to the contents of its charter, do not render the contract of the subscriber voidable. If a person makes a contract, he must at his peril inform himself as to the legal consequences of his undertaking; a simple misunderstanding about the legal effect of a contract, though brought about by the fraud of the other party, is not a ground of avoidance. If this were not the rule, it is obvious that mutual dealings would not be possible.

A person taking shares in a corporation necessarily undertakes to become a member of a particular corporation, and to become invested with the privileges and duties which are incidental to that position. The terms of this contract are written in the charter or articles of association, and the general laws of the land. Every subscription for shares must necessarily refer to these, and incorporate their provisions; for they are the constitution of the association of which the subscriber agrees to become a member. And hence it follows that a subscriber for shares must, at his peril, not only ascertain the contents of the subscription paper which he signs, but also the provisions of the charter of the company, or its articles of association, and the general laws. A fraudulent representation relating to either of these matters, or to the rights and duties resulting from membership in the company, does not give the subscriber a right to avoid his contract.²

¹ *Parker v. Thomas*, 19 Ind. 213; *Albany, &c. R. R. Co. v. Fields*, *Upton v. Tribilcock*, 91 U. S. 45. 10 Ind. 187, 190, *Davison, J.*, said:

² *Ellison v. Mobile, &c. R. R.* "A party is presumed to know the Co., 36 Miss. 572-588. In New contents of the instruments which

§ 97. However, a fraudulent representation about the actual contents of a subscription paper or articles of association may, when there is no negligence on the part of the subscriber, be a good ground for avoiding the contract, as in case of a false representation about any other existing fact. Thus, where a person who was unable to read, and who did not know the contents of the articles of association of a company, was induced to become a shareholder by means of a false representation that, according to the conditions contained in the articles, he would not be required to pay for his stock until the amount of \$20,000 had been subscribed, it was held that the subscriber was entitled to repudiate his subscription on account of the fraud.¹

So, if a person signs a subscription paper, entirely misunderstanding the nature of the instrument which he is signing, his subscription must be treated as null and void for want of mutual consent. In this case the question of fraud is not material.²

§ 98. Representations must not amount to Promises, nor relate to Matters of Opinion. — A contract is voidable for a

he signs, and has, therefore, no right to rely upon the statement of the other party as to its legal effect. In this instance the agreement is very explicit. It binds the defendant unconditionally to pay each instalment at a stated period. Hence the verbal statement of the agent, that the defendant's signature would not be binding unless he attended the meeting and signed his name to the stock-books, must be held a mere representation as to the legal effect of the subscription, and, though false, it could not deceive the defendant, because the agreement to which he then subscribed his name binds him absolutely to pay in instalments." See also *Clem v. Newcastle, &c. R. R. Co.*, 9 Ind. 488; *Selma, &c. R. R. Co. v. Anderson*, 51 Miss. 829; *Thornburgh v. Newcastle, &c.*

R. R. Co., 14 Ind. 499; *Wight v. Shelby R. R. Co.*, 16 B. Monr. 5; *Smith v. Reese River Co.*, L. R. 2 Eq. 269; *Vicksburg, &c. R. R. Co. v. McKean*, 12 La. Ann. 638.

¹ *Wert v. Crawfordsville, &c. Turnpike Co.*, 19 Ind. 242. *Davison, J.*, said: "The representations thus made were not mere opinions, but referred to a material fact as to the contents of the articles of association."

² See *Thoroughgood's Case*, 2 Co. Rep. 9 b; *Foster v. Mackinnon*, L. R. 4 C. P. 704, 711; *Kennedy v. Green*, 3 M. & K. 699, 717; *Ogilvie v. Jeaffreson*, 2 Giff. 353; *Rockford, &c. R. R. Co. v. Shunick*, 65 Ill. 223; *Jackson v. Hayner*, 12 Johns. 469; *County of Schuylkill v. Copley*, 67 Pa. St. 386.

fraudulent representation of *facts*, but not for a breach of agreement by either of the contracting parties. Hence a failure on the part of a corporation to comply with the special terms of a subscription for shares does not render the contract of the shareholder voidable, but is merely a cause for an action against the company.

Subscriptions obtained by an agent of a corporation, by means of false and fraudulent statements concerning the happening of a future event or the doing of a future act, cannot as a rule be avoided. Considered as promises, such statements would not be admissible in evidence, for the reason that a written contract cannot be varied by proof of a contemporaneous verbal agreement; and even if proven they would be wholly immaterial. Regarded as representations, they would be immaterial because relating to matters of opinion merely,—concerning the probability or improbability of the happening of the future event or the doing of the future act.

Thus, for example, a statement made by an agent obtaining subscriptions for shares in a railroad company, to the effect that the proposed road would be built upon a certain route or within a certain period of time, would not render a subscription made upon the faith of it voidable, though the statement be made with the intention to deceive, and the road be not built upon the route or within the time indicated.¹

¹ *Chouteau Ins. Co. v. Floyd*, 74 Mo. 286; *New Albany, &c. R. R. Co. v. Fields*, 10 Ind. 187; *Bish v. Bradford*, 17 Ind. 490; *Johnson v. Crawfordsville, &c. R. R. Co.*, 11 Ind. 280; *Evansville, &c. R. R. Co. v. Posey*, 12 Ind. 363; *Mississippi, &c. R. R. Co. v. Cross*, 20 Ark. 454; *Martin v. Pensacola, &c. R. R. Co.*, 8 Fla. 370; *Eakright v. Logansport, &c. R. R. Co.*, 13 Ind. 404; *Parker v. Thomas*, 19 Ind. 214; *Ellison v. Mobile, &c. R. R. Co.*, 36 Miss. 572. Compare *Piscataqua Ferry Co. v. Jones*, 39 N. H. 491; *East Tennessee, &c. R. R. Co. v. Gammon*, 5 Sneed, 567; *Walker v. Mobile, &c. R. R. Co.*, 34 Miss. 246; *Crossman v. Penrose Ferry Bridge Co.*, 26 Pa. St. 69; *Kelsey v. Northern Light Oil Co.*, 54 Barb. 111, see dissenting opinion of Mullin, J.; *Saffold v. Barnes*, 39 Miss. 399. Compare *Miller v. Hanover Junction, &c. R. R. Co.*, 87 Pa. St. 95; *Smith v. Tallassee Plank Road Co.*, 30 Ala. 650.

It has been assumed in various cases, that, if the subscription agents of a railroad company obtain subscriptions for shares by fraudulently stating to the subscribers that the

§ 99. The same principle applies with regard to representations concerning existing facts, where it is known that such representations are merely expressions of opinion or judgment. A subscriber for shares cannot be supposed to rely upon the judgment of an agent who is endeavoring to procure subscriptions on behalf of the company; and hence false statements made by such agent with regard merely to matters of opinion or belief will not, as a rule, be a ground for avoiding the subscriber's contract. Thus, it was held in *Bish v. Bradford*,¹ that representations fraudulently made to a subscriber for shares in a railroad company, to the effect that sufficient stock had already been subscribed to complete the road in eighteen months, would not render the subscription voidable. The court said: "They are but mere expressions of opinion upon an existing fact, and its connection with a future event. It will be observed that no particular amount of means were represented to have been possessed by the company. . . . How much it would cost to build the road, or whether the means would hold out, depended upon events which probably neither the corporation nor the defendant could foresee."

So representations as to the value of a thing are usually considered mere statements of opinion.²

§ 100. **The Subscriber must have been imposed upon.**—In order that a person may avoid his contract, on account of false representations, it is necessary, of course, that he should have been imposed upon, and the imposition must not have occurred through his own fault. In *Hallows v. Fernie*,³ Lord

company's railroad would thereafter be built upon a certain line or in a certain manner, the subscribers may rescind their subscriptions if the railroad is not so built. *Henderson v. Railroad Co.*, 17 Tex. 560, 580; *Atlanta, &c. R. R. Co. v. Hodnett*, 36 Ga. 669; *Rives v. Montgomery, &c. Plank Road Co.*, 30 Ala. 92. These cases are, however, contrary to elementary principles of the law of contracts, and ought not to be followed.

¹ *Bish v. Bradford*, 17 Ind. 490,

493; *Hardy v. Merriweather*, 14 Ind. 203; *Walker v. Mobile, &c. R. R. Co.*, 34 Miss. 245; *Brownlee v. Ohio, &c. R. R. Co.*, 18 Ind. 68; *Selma, &c. R. R. Co. v. Anderson*, 51 Miss. 829; *Coil v. Pittsburgh Female College*, 40 Pa. St. 439; *Oregon Cent. R. R. Co. v. Scoggin*, 3 Oreg. 161.

² *Union Nat. Bank v. Hunt*, 76 Mo. 439.

³ *Hallows v. Fernie*, L. R. 3 Ch. 477; *Jennings v. Broughton*, 22 L. J. Ch. 585.

Chelmsford, L. C., said: "If a person purchases shares in a company upon the faith of a prospectus, and is referred to any document which will show the untruth or inaccuracy of any of its statements, and chooses not to make use of his means of knowledge, but to continue in a state of wilful ignorance of the facts, he cannot afterwards be heard to complain that he has been deceived by the alleged misstatements. In considering the question of knowledge, or means of knowledge, it is important to see whether the plaintiff was a person likely, through inexperience, to be misled by a prospectus, or to place implicit reliance upon all that it contains."

Yet a person is not required to use more than ordinary caution in dealing with the directors of a company; and it is not a want of ordinary caution to trust that their statements upon matters of fact are honestly made. Hence it was said by the same Lord Chancellor, in the House of Lords: "It appears to me, that, when once it is established that there has been any fraudulent misrepresentation or wilful concealment by which a person has been induced to enter into a contract, it is no answer to his claim to be relieved from it, to tell him that he might have known the truth by proper inquiry. He has a right to retort upon his objector, 'You at least, who have stated what is untrue, or have concealed the truth, for the purpose of drawing me into a contract, cannot accuse me of want of caution because I relied implicitly upon your fairness and honesty.'"¹

It is but fair to assume that a person who reads a prospectus knows that its statements are probably highly colored, and that he has taken that fact into consideration. Lord Romilly said: "Anybody who looks at a prospectus understands that the thing is colored, in this sense, that everything is put forward in the most favorable view it can be."²

¹ *Central Ry. Co. v. Kisch*, L. R. F. 947; *New Brunswick, &c. Ry. Co. v. Muggeridge*, 1 Dr. & Sm. 381, 382. See also *Mead v. Bunn*, 32 N. Y. 280; *McClellan v. Scott*, 24 Wis. 87.
² *Denton v. Macneil*, L. R. 2 Eq. 355; *Kisch v. Central Ry. Co.*,
 2 H. L. 120; *Smith v. Reese*, 2 Eq. 264, and 4
 River Co., L. R. 2 Eq. 264, and 4
 H. L. 64; *Waterhouse v. Jamieson*,
 L. R. 2 H. L. Sc. 29; *Upton v.*
 Englehart, 3 Dill. 501; *Glamorgan-*
 shire Iron, &c. Co. v. Irvine, 4 F. &

§ 101. **The Representations must have been a Material Inducement.**—The contract of a shareholder will not be rendered voidable by a fraudulent representation, unless it can be reasonably inferred that the representation was a material inducement to the shareholder to enter into his contract. In *Pulsford v. Richards*,¹ which was a bill in chancery to rescind a contract for shares, on account of false representations in the prospectus, upon the faith of which the shares had been taken, Lord Romilly said: "It is almost needless to add, that it must appear that the person deceived entered into the contract on the faith of it. To use the expression of the Roman law (much commented on in the argument before me), it must be a representation *dans locum contractui*, that is, a representation giving occasion to the contract: the proper interpretation of which appears to me to be the assertion of a fact on which the person entering into the contract relied, and in the absence of which it is reasonable to infer that he would not have entered into it; or the suppression of a fact, the knowledge of which, it is reasonable to infer, would have made him abstain from the contract altogether."

It was accordingly held by the Supreme Court of Indiana, that fraudulent representations made by an agent soliciting subscriptions for shares in a railroad company, to the effect that the persons having the contract to construct and equip the road were able to complete the same out of their own resources, would not enable a subscriber to repudiate his contract. The court said: "We cannot see how either the truth or falsity of such statement should have influenced the action of the defendant in subscribing."²

§ 102. **The Representations must have been within the Scope of the Powers of the Agents making them.**—It is clear that a corporation is in no case bound by fraudulent representations

34 L. J. Ch. 545, *per* Lord Justice Turner; *Hughes v. Antietam Manuf. Co.*, 34 Md. 316.

¹ *Pulsford v. Richards*, 17 Beavan, 96.

² *Andrews v. Ohio, &c. R. R. Co.*, 14 Ind. 169, 173. See also

Walker v. Mobile, &c. R. R. Co., 34 Miss. 246; *Jennings v. Broughton*, 22 L. J. Ch. 585. See *Nicol's Case*, 3 De G. & J. 387; and compare *Watson v. Earl Charlemont*, 12 Q. B. 856.

made by a mere stranger. The rule is well settled, that a principal is bound by the fraudulent representations of his agents only when made within the scope of the authority with which the agent has apparently been invested. In applying this rule to representations made by the agents authorized to procure subscriptions for shares, it is important to distinguish between agents appointed before the organization of a company, and such agents as were appointed by an organized corporate body. The powers of agents appointed pursuant to a statute, for the purpose of opening stock-books before the formation of a company, are of a ministerial character only. They cannot be presumed to have any authority to make representations, except with regard to the powers expressly conferred upon them by law; and these do not extend beyond the mere act of receiving unconditional subscriptions for shares.¹

It has been held that fraudulent representations made by commissioners prior to the organization of a company in order to induce subscriptions are not a ground for avoiding the subscriptions, because the commissioners are not agents for the company.² This reasoning seems to carry too far, and makes the rights of parties depend on a barren technicality. The commissioners do, in fact, act on behalf of all the shareholders constituting the corporation, and it would be evident injustice to allow the corporation to take the benefit of their contracts if induced by fraud in the exercise of their statutory powers. Thus, the commissioners have authority under the statute to keep the subscription-books and receive valid subscriptions only. It would be their duty to exclude fictitious or forged subscriptions from the books; and if they should fraudulently allow fictitious or forged subscriptions to be made, and fraudulently represent them to be valid, any subsequent subscriber relying on the representation would clearly be entitled to avoid his contract on the ground of fraud.

¹ *Supra*, §§ 66, 83.

² See *Rutz v. Esler, &c. Manuf. Co.*, 3 Bradw. 83.

§ 103. **Representations by Agents of the Company.**—The general rule is, that representations made by an agent of a corporation do not bind the company or constitute a ground for avoiding a subscription for shares, unless the agent was of such a character as to have apparent authority to make the statements.¹ Thus, it was held, in *Burnes v. Pennell*,² that a purchaser of shares could not relieve himself of his contract by reason of false representations made by the law agent of the company concerning its financial condition. The purchaser was not entitled to trust to such representations, inasmuch as they were wholly outside of the agent's apparent powers.

The directors of a company are invested with a general authority to manage its affairs. And therefore, if a prospectus issued by the directors of a company, or by their authority, contains any false statement with regard to the condition of the company's affairs, or its business arrangements, the company will be bound by them.³

In *Waldo v. Chicago, &c. R. R. Co.*,⁴ a subscription was voidable on the ground that it had been induced by false representations as to the company's financial condition. The agents receiving the subscriptions were a committee appointed by the directors for that purpose. The court said: "It is very clear that those representations as to the pecuniary condition of the company and the earnings of the road were material, and were such as the respondent had a right to rely upon when he sold his land for the stock of the corporation. He could not know what the road was earning, or that the company, instead of being in a sound financial condition, was just upon the eve of bankruptcy. It is evident that these matters, which fixed the value of the stock, could only be

¹ *Custar v. Titusville Gas, &c. Co.*, 63 Pa. St. 381; *First Nat. Bank v. Hurford*, 29 Iowa, 579; *Goodrich v. Reynolds*, 31 Ill. 490; *Ayre's Case*, 25 Beav. 513; *Nicol's Case*, 3 De G. & J. 387; *Western Bank v. Addie*, L. R. 1 H. L. Sc. 145; *Smith v. Tallassee Plank Road Co.*, 30 Ala. 650; *Rives v. Mont-*

gomery, &c. Plank Road Co., 30 Ala. 92.

² *Burnes v. Pennell*, 2 H. L. Cas. 497.

³ *Ayre's Case*, 25 Beav. 513; *Smith v. Reese River Co.*, L. R. 2 Eq. 264; *Ex parte Worth*, 4 Dr. 529.

⁴ *Waldo v. Chicago, &c. R. R. Co.*, 14 Wis. 575.

known to the agents and officers of the road. They had access to the books and records of the company, knew what the road was earning, and whether the company was solvent, and nothing was more reasonable or natural than that a party about to subscribe for stock should rely on the statements of its officers and agents, who were around soliciting subscriptions. It is said that the company ought not to be held responsible for the misrepresentations of its agents, but we think otherwise. They were going about the country obtaining subscriptions, and whatever fraudulent representations they made as to the condition of the road and the value of the stock while doing this must be deemed to be made by them in the execution of their agency, and for which the company is liable. This, we think, is very clear from the authorities."¹

§ 104. **The Representations must have been made fraudulently.**—False representations do not render a contract made on the faith of them voidable, unless they were made fraudulently. But it is not essential that there be actual knowledge of the falsity of the statements, if they were made recklessly, in ignorance of their truth or falsity. This principle applies forcibly in case of statements made by the directors or other managing agents of a company, with regard to its internal affairs. The managing agents of a company should be presumed to be acquainted with the affairs of the company within their charge; for such acquaintance is necessary to enable them to perform their ordinary duties properly. And if statements concerning the affairs of a company are put forth in the prospectus issued by the directors, the public are entitled to assume that such statements were made with knowledge of their truth or falsity.²

¹ Citing *Sandford v. Handy*, 23 Wend. 260; *Gibson v. D'Este*, 21 Eng. Ch. R. 542; 2 Y. & C. N. R. 542, 570; *Philadelphia, &c. R. R. Co. v. Quigley*, 21 How. 202.

² See *Smith v. Reese River Co.*, L. R. 2 Eq. 268, 269, 4 H. L. 64; *Glamorganshire Iron, &c. Co. v. Ir-*

vine, 4 F. & F. 947, 955. See *Goodrich v. Reynolds*, 31 Ill. 490; *Nelson v. Luling*, 36 N. Y. Super. Ct. 544; *Salem Mill Dam Co. v. Ropes*, 9 Pick. 187; *Coil v. Pittsburgh Female College*, 40 Pa. St. 439; *City Bank v. Bartlett*, 71 Ga. 797, 808.

§ 105. **What Fraudulent Representations enable a Subscriber to avoid his Contract.**—It may be stated, as a general rule, that any false representation which induces a person to become a shareholder in a corporation, if made by an agent acting within the general scope of his powers, will enable the shareholder to repudiate his contract. Such representations may be made in writing or by parol, by word or act, or even by mere silence. If a corporation, through its proper agents, issues a prospectus to induce the public to subscribe for shares, a person taking shares on the faith of it is entitled to assume that the prospectus contains a fair representation of the actual state of the company. Vice-Chancellor Kindersley said: "It appears to me quite necessary to uphold this as a principle, that those who issue a prospectus holding out to the public the great advantages which will accrue to persons who will take shares in a proposed undertaking, and inviting them to take shares on the faith of the representations therein contained, are bound to state everything with strict and scrupulous accuracy; and not only to abstain from stating as facts that which is not so, but to omit no one fact within their knowledge, the existence of which might in any degree affect the nature or extent or quality of the privileges and advantages which the prospectus holds out as inducements to take shares."¹

§ 106. Whether or not the contract of a shareholder be voidable for false representations must necessarily depend, in each case, upon all the facts and circumstances. It may, however, be stated as a general rule, that any fraudulent representation with regard to the financial state of a company,² or its arrangements for carrying out its

¹ *New Brunswick, &c. Ry. Co. v. Muggeridge*, 1 Dr. & Sm. 363, 381, cited with approval in *Henderson v. Lacon*, L. R. 5 Eq. 252; *Central Ry. Co. v. Kisch*, L. R. 2 H. L. 113. Compare *Pulsford v. Richards*, 17 Beav. 87.

² *Water Valley Manuf. Co. v. Sea-*

man, 53 Miss. 655; *City Bank v. Bartlett*, 71 Ga. 797, 808; *Waldo v. Chicago, &c. R. R. Co.*, 14 Wis. 575; *Melendy v. Keen*, 89 Ill. 395; *Bradley v. Poole*, 98 Mass. 169. See *McClellan v. Scott*, 24 Wis. 87. Compare *Selma, &c. R. R. Co. v. Anderson*, 51 Miss. 829.

enterprise,¹ or with regard to any other fact which can reasonably be supposed to have been material in inducing a person to become a shareholder, will enable the latter to avoid his contract. If a person is induced to take shares by a false representation that another person has become a shareholder,² or that certain persons have agreed to act as directors of the company,³ this will be a ground for avoiding the subscription; but it must appear in such case that the subscriber relied upon the statement, and was induced thereby to take the shares.⁴

§ 107. The fact that certain persons have subscribed for shares, subject to a secret agreement that their subscriptions should be merely colorable, and for the purpose of inducing others to subscribe, is not a ground for avoiding subsequent subscriptions, though they were made in the belief that the former were *bona fide*; for the secret agreements that the subscriptions should be merely colorable would be void, and the subscriptions made subject thereto be absolutely binding upon the subscribers.⁵ A different principle would, however, be applicable where the prior subscriptions, held out as decoys, were entirely fictitious, or were made by persons unable to perform the obligations of shareholders by reason of insolvency or for any other cause.⁶

§ 108. **The Right to avoid a Subscription induced by Fraud is barred by Laches.**— If a person has been induced by fraud-

¹ Vreeland v. N. J. Stone Co., 29 N. J. Eq. 190; Smith v. Reese River Co., L. R. 2 Eq. 264, and 2 Ch. 604; Ross v. Estates Investment Co., L. R. 3 Ch. 682; Central Ry. Co. v. Kisch, L. R. 2 H. L. 99, 119.

² Henderson v. Lacon, L. R. 5 Eq. 249. Compare Ross v. Estates Inv. Co., L. R. 3 Ch. 682; Cunningham v. Edgefield, &c. R. R. Co., 2 Head, 23.

³ Blake's Case, 34 Beav. 639. Compare Hallows v. Fernie, L. R. 3 Ch. 467.

⁴ Walker v. Mobile, &c. R. R. Co., 84 Miss. 246.

⁵ Connecticut, &c. R. R. Co. v.

Bailey, 24 Vt. 465, 476; Jewett v. Valley Ry. Co., 34 Ohio St. 601. See *infra*, §§ 302, 303. Compare Custar v. Titusville Gas, &c. Co., 63 Pa. St. 381; Hayden v. Atlanta Cotton Factory, 61 Ga. 234.

⁶ See Henderson v. Lacon, L. R. 5 Eq. 249; and compare Ross v. Estates Inv. Co., L. R. 3 Ch. 682; Cunningham v. Edgefield, &c. R. R. Co., 2 Head, 23; Pulsford v. Richards, 17 Beav. 87; Vane v. Cobbold, 1 Exch. 798; Centre, &c. Turnpike Co. v. McConaby, 16 S. & R. 140; Occidental Ins. Co. v. Ganzhorn, 2 Mo. App. 205.

ulent representations to become a member of a corporation, he must proceed with the utmost diligence if he desires to annul his contract. This rule is founded upon the most obvious principle of justice. A contract induced by fraud is valid until avoided by the innocent party. And a person who has been induced by fraud or deception to take shares in a corporation is in every respect a shareholder, and entitled to the benefits of membership, until he has elected to repudiate his contract. If, then, he were permitted to delay declaring his contract void on account of the fraud, injustice would be done the other shareholders; for the former would be enabled to speculate upon the value of his shares,—to repudiate them if the speculation should prove a failure, and to hold them valid in case of success. Lord Romilly said: “The leading principle in all these cases is this: a man must not play fast and loose; he must not say, ‘I will abide by the company if successful, and I will leave the company if it fails’; and therefore, whenever a misrepresentation is made of which any one of the shareholders has notice, and can take advantage of to avoid his contract with the company, it is his duty to determine at once whether he will depart from the company, or whether he will remain a member.”¹

Diligence is also required, lest other persons be misled by the fact of his remaining a member of the association.²

It is clear that, if a stockholder, with notice of facts enabling him to repudiate his contract on account of fraudulent representations, has elected to treat his contract as valid, he cannot afterwards refuse to be bound by it. And therefore it is a rule that a person who was induced by fraud to purchase shares in a corporation cannot avoid his contract, if, after having acquired notice of the fraud, he has received any benefit from his shares, or in any manner has acted as stockholder.³

¹ *Ashley's Case*, L. R. 9 Eq. 263, 268. 23; *Upton v. Tribilcock*, 91 U. S. 45, 55, citing *Smith's Case*, L. R. 2 Ch.

² See *Central Ry. Co. v. Kisch*, L. R. 2 H. L. 99; *Upton v. Englehart*, 3 Dill. 496, 502; *Cunningham v. Edgefield, &c. R. R. Co.*, 2 Head, 613; *Denton v. Macneil*, L. R. 2 Eq. 352; *Peel's Case*, L. R. 2 Ch. 684.

³ *Ogilvie v. Knox Ins. Co.*, 22 How. 380; *Chubb v. Upton*, 95 U. S.

PART IV.

RESCISSION OF THE CONTRACT OF MEMBERSHIP.

§ 109. **The General Rule.** — The contract of membership in a corporation is not impliedly terminable at the will of either of the parties to it, as in case of an ordinary contract of partnership; the general rule is, that a shareholder in a corporation has no power to dissolve his connection with the company of which he is a member.¹ Nor can the agents of a corporation consent, on behalf of the company, to the withdrawal of any shareholder.² This follows from the intentions of the parties, the character of their contract, and their obligations to creditors and the State.

In *Bedford Railroad Co. v. Bowser*,³ the Supreme Court of Pennsylvania decided that the directors of a railroad company had no power to consent to a cancellation of the shares of a subscriber, although the company was fully solvent at the time. Strong, J., delivering the opinion, said: "Directors of a railroad company are trustees for all the stockholders, and, in a very just sense, for the Commonwealth. It is an abuse of their trust, wholly unauthorized, and at war with the design of the charter, to single out some of the stock subscribers and release them from their liability. No such authority in them has ever been recognized. It is neither supported by authority or reason."

The general rule is, that a shareholder in a corporation can escape from the obligation of his contract only by one

665; *Farrar v. Walker*, 13 Bank. Reg. 82; *Litchfield Bank v. Church*, 29 Conn. 137; *Centre, &c. Turnpike Co. v. McConaby*, 16 S. & R. 140; *Parks v. Evansville, &c. R. R. Co.*, 23 Ind. 567; *Hamilton v. Grangers' Life, &c. Ins. Co.*, 67 Ga. 145. Compare *Wontner v. Shairp*, 4 C. B. 404.

¹ *United Society v. Eagle Bank*,

7 Conn. 457; *Bishop's Fund v. Eagle Bank*, 7 Conn. 476; *Selma, &c. R. R. Co. v. Tipton*, 5 Ala. 809.

² *Bedford R. R. Co. v. Bowser*, 48 Pa. St. 29; *Hughes v. Antietam Manuf. Co.*, 34 Md. 318; *Jewett v. Valley Ry. Co.*, 34 Ohio St. 601.

³ 48 Pa. St. 34, 37.

of the following methods: (1.) by a transfer of his shares and an acceptance of the transfer on the part of the corporation, thus effecting a complete novation;¹ (2.) by a forfeiture and sale under authority expressly conferred upon the company by its charter;² (3.) dissolution of the company;³ (4.) by act of the majority in winding up the business of the company and surrendering its charter;⁴ (5.) by act of the shareholder, where permission to withdraw is expressly conferred by the charter;⁵ (6.) by unanimous consent of the members of the company, under legislative authority.⁶

§ 110. Attention is again called to the essential difference between the contract of membership in a corporation, and a contract to buy shares or to subscribe for shares at a future time. The former contract, being the bond of union between all the shareholders, cannot be rescinded by any shareholder even with the consent of the directors. The latter contract is an ordinary executory contract between the corporation, on the one side, and the party agreeing to purchase shares or to become a shareholder, on the other side.⁷ There is no reason why the directors should not have the power to agree to a rescission or alteration of a contract of this description, as in case of any other contract entered into by the corporation in the transaction of its ordinary business.

§ 111. **The Nature and Effect of a Cancellation of Shares.**—A cancellation of shares, or the release of a shareholder, must not be confounded with the cancellation of a certificate of shares. A certificate of shares is merely evidence that the holder is a shareholder, and to cancel it would not of itself release him from membership in the company. If a certificate of shares should be issued illegally, or to a wrong person, it would not constitute the holder a shareholder, and its cancel-

¹ *Infra*, § 159.

² *Infra*, § 122.

³ *Infra*, § 982.

⁴ *Infra*, § 413.

⁵ But the provisions of the char-

ter must be strictly followed in this case. *Greenville, &c. R. R. Co. v. Smith*, 6 Rich. L. 91.

⁶ *Infra*, § 119.

⁷ *Supra*, § 61.

lation would merely destroy an invalid instrument which had been issued in the name of the corporation.

The withdrawal of a shareholder would, of course, reduce the amount of the outstanding shares in the company to that extent. Whether it would also reduce the amount of the company's assets or capital would depend upon circumstances. The cancellation of shares which have not been fully paid up would deprive the corporation of the right to call upon the holder who was discharged to contribute the amount of the shares to the company's capital. This liability of a shareholder to contribute his proportionate part of capital is for the common benefit of all the shareholders. It constitutes a portion of the company's capital or assets, and is pledged to creditors as security for their claims. To release a subscriber or holder of shares which have not been fully paid up would therefore necessarily reduce the assets or capital of the corporation, and would be in violation of the rights both of creditors and of the remaining members.¹

The withdrawal of a shareholder whose shares have been fully paid up would not be injurious to the corporation or to creditors, if the departing shareholder does not take away any portion of the company's assets, and if there is no individual liability to creditors. It is obvious, however, that no shareholder would be willing to withdraw upon any such conditions; for he would thereby in effect make a gift to the corporation of the full value of his shares. The withdrawal of a shareholder whose shares have been paid up would usually take the form of a purchase of the shares by the corporation. In this way the departing member would give up his interest in the whole concern, and would receive the value thereof out of the company's assets.

§ 112. **Purchase by Corporation of Shares in itself.** — A purchase by a corporation of shares of its own stock, in effect, amounts to a withdrawal of the shareholder whose shares

¹ Bedford R. R. Co. v. Bowser, holders, see *infra*, § 302. As to 48 Pa. St. 29; Gill v. Balis, 72 Mo. the rights of creditors, see *infra*, 424. As to the rights of the share- § 804.

are purchased from membership in the company, and a repayment of his proportionate share of the company's assets. There is no substitution of membership under these circumstances, as in case of a purchase and transfer of shares to a third person, but the members of the company and the amount of its capital are actually diminished. Whatever a transaction of this character may be called in legal phraseology, it is clear that it really involves an alteration of the company's constitution, just as the withdrawal of a member of a copartnership, with his proportionate share of the joint funds, involves an alteration of the constitution of a copartnership. The amount of the company's assets and the number of its shareholders are diminished. Every continuing shareholder is injured by the reduction of the fund contributed for the common venture; and the creditors who have trusted the company upon the security of the capital originally subscribed, or who are entitled to expect that amount of security, are entitled to complain.¹

It is no answer to say that shares having a market value must be regarded like any other personal property, and that no person is injured if a solvent corporation in good faith purchases shares in itself at their market value, inasmuch as the shares so purchased are property in the hands of the company, and may at any time be reissued or sold. No verbiage can disguise the fact, that a purchase by a corporation of shares in itself really amounts to a reduction of the company's assets, and that the shares purchased do in fact remain extinguished, at least until the reissue has taken place. The fact that such a transaction may not necessarily be injurious to any person is not a sufficient reason for supporting it. It is contrary to the fundamental agreement of the shareholders, and is condemned by the plainest dictates of sound policy. To allow the directors to exercise such a power would be a fruitful source of unfairness, mismanagement, and corruption. It is for these reasons that a shareholder cannot be allowed to withdraw from the corporation with his proportionate

¹ See *infra*, §§ 769, 804, 821.

amount of capital, either by a release and cancellation before the shares have been paid up, or by a purchase of the shares with the company's funds.¹

§ 113. The decisions of the courts are not all in accord with the principles and authorities referred to in the preceding sections.

In *City Bank of Columbus v. Bruce*,² it appeared that the directors of a banking corporation had passed a resolution authorizing all the shareholders who were indebted to the corporation on account of stock notes to cancel their indebtedness by surrendering their shares to the company at a specified rate, and that nearly one half of all the shares in the company had been surrendered accordingly. The Court of Appeals of New York held that this transaction was in violation of no principle of the common law.

¹ *German Savings Bank v. Wulfe-kuhler*, 19 Kans. 60; *Abeles v. Cochran*, 22 Kans. 405; *State v. Oberlin Building Ass.*, 35 Ohio St. 258; *Coppin v. Greenlees, &c. Co.*, 38 Ohio St. 275; *Currier v. Lebanon Slate Co.*, 56 N. H. 262; *Johnson v. Bush*, 3 Barb. Ch. 207; *Zulueta's Claim*, L. R. 5 Ch. 444; *Re Marseilles Extension Ry. Co.*, L. R. 7 Ch. 161. Compare *Jones v. Morrison*, 31 Minn. 140. See also *infra* § 434.

In *Percy v. Millaudon*, 3 La. 570, 585, *Martin, J.*, delivering the opinion of the court, said: "Creditors and customers have a claim to the preservation of the capital in its original integrity; for it is the pledge on the faith of which they accept the notes of the institution, deposit their money, and lodge paper for collection. So has the public, on account of the advantages which the legislature has stipulated the bank should afford, as a consideration for the immunities and privileges which the charter confers. So have the

stockholders, on account of the profits which they have a right to expect on the investments they have respectively made. Thus, by the reduction of the capital, the directors of a bank violate their duties towards its creditors and customers, the public and the stockholders. The claim of the first is the more sacred; for, unless justice be done to these, the public has a right to no advantage, and the stockholders to no profit. . . . The reduction of the capital, by subjecting the shares of the remaining stockholders to a greater portion of the debts of the bank than they had agreed to be bound for, works an injury to them respectively. Each had a right, which he had exercised at the time of his subscription or of his purchase of stock, to determine what stake he should hold in the affairs of the corporation, particularly what part of its passive debts the funds he invested would be liable for."

² *City Bank v. Bruce*, 17 N. Y. 507; compare *Hartridge v. Rockwell*, R. M. Charlton (Georgia),

In *Chicago, &c. R. R. Co. v. Marseilles*,¹ the Supreme Court of Illinois held that the directors of a railroad company had a general authority to purchase shares in the company on its behalf, unless expressly prohibited by the charter.

In *Chetlain v. Republic Life Ins. Co.*,² the same court held that a resolution authorizing those shareholders in a life insurance company who had paid twenty per cent on their subscriptions to call for a like percentage of all of their shares as fully paid up, upon consenting to have the remainder cancelled, was valid. The court said: "This in no sense diminished the amount of the capital stock of the company. Where a person had subscribed for, say, ten shares, and had paid \$200, and was willing to receive a certificate for two shares of \$100 each, and cancel his subscription for the ten shares, the other eight still belong to the company, and they could sell them to whom they might choose. The subscription for shares, and the twenty per cent thereon, did not vest any title to the shares in the purchaser. That would only be a contract to purchase and pay for the number of shares for which the subscription was made. Until paid for, and the purchaser received his certificate of stock, the title to the shares was still in the company." This reasoning indicates a complete misconception of the nature of a stock subscription, and the resulting rights and obligations, as well as of the real character and consequences of a purchase by a company of shares in itself.

In *Iowa Lumber Co. v. Foster*,³ the Supreme Court of Iowa held that a company whose articles of association authorized it to purchase and hold "any real estate *or other property* that may be deemed desirable in the transaction of its business," might purchase and hold shares of stock in itself.

260; *Verplanck v. Mercantile Ins. Co.*, 1 Edw. Ch. 84.

¹ *Chicago, &c. R. R. Co. v. Marseilles*, 84 Ill. 643.

² *Chetlain v. Republic Life Ins. Co.*, 86 Ill. 220. Compare *Melvin v. Lamar Ins. Co.*, 80 Ill. 446; *Zir-*

kel v. Joliet Opera House Co., 79 Ill. 334; *Klein v. Alton, &c. R. R. Co.*, 13 Ill. 514; *Ryder v. Alton, &c. R. R. Co.*, Id. 516. See, however, *Clapp v. Peterson*, 104 Ill. 26, 33.

³ *Iowa Lumber Co. v. Foster*, 49 Iowa, 25.

If these decisions are carried to their logical results, it is apparent that a corporation may, at any time, by an easy process, be made to shrink away and finally vanish into nothing. It would only be necessary to "purchase" shares from its stockholders. And in the end, after the last stockholder had "sold" his own shares to the company and withdrawn with the proceeds, nothing material would remain to attest the former existence of the corporation except an empty treasury and cancelled stock certificates.

§ 114. **Exceptions to the Rule.** — The directors of a corporation may, however, receive shares in the company by way of gift or bequest,¹ or in satisfaction of debts due the company which cannot be collected in any other manner.² In these cases the objections which apply to a purchase of shares under ordinary circumstances have no application, for the company's actual capital is not thereby diminished. It has been held, for similar reasons, that, where there is a *bona fide* dispute as to the liability of a subscriber or the validity of his shares, the directors may in good faith enter into a compromise by which the subscriber is discharged and his shares are cancelled.³

If the charter of a corporation expressly provides that it may diminish the amount of its capital stock, this may be accomplished either by cancelling subscriptions before anything has been paid upon them into the treasury, or by purchasing the shares for their real value, if wholly or partly paid up. It would be necessary, however, to follow strictly the forms and methods prescribed by law.

If shares in a corporation are purchased by the company, they may, unless the contrary be provided, be reissued at a subsequent time. Under these circumstances, it is said, the shares do not become merged, but remain temporarily in abeyance, and may be sold again by the corporation.⁴ As a

¹ *Rivanna Navigation Co. v. son, &c. Plank Road Co.*, 17 Barb. Dawsons, 3 Gratt. 19. 397; *Cooper v. Frederick*, 9 Ala. 738.

² *Williams v. Savage Manuf. Co.*, 3 Md. Ch. 418; *Lathrop v. Kneeland*, 46 Barb. 432; *Taylor v. Miami Exp. Co.*, 6 Ohio, 177; *State Bank v. Fox*, 3 Blatchf. 431; *Barton v. Port Jack-* ³ *State v. Oberlin Building Ass.*, 35 Ohio St. 258; *New Albany v. Burke*, 11 Wall. 96; *Lord Belhaven's Case*, 3 De G., J. & S. 41.

⁴ See *State v. Smith*, 48 Vt. 266;

matter of fact, however, the shares are extinguished, and new shares are subsequently created in their place. By a fiction these new shares are considered in all respects as if they were the old shares and the corporation merely an intermediate transferee; but it would be an absurdity to say that a corporation can really hold shares in itself.¹

§ 115. **Violation of the Charter no Cause for Rescission.** — An ordinary contract may be rescinded at any time, by mutual agreement of the parties, and a voluntary rescission may in some instances be implied from the acts of the parties without any express agreement. Thus, if one of the parties to a contract wholly fails to perform his part of it, the other party will often be at liberty to consider the contract ended by mutual consent. If a contract consists of mutual promises, the due performance by the one party is in many instances an implied condition precedent to the obligation of the other party to perform the agreement on his side, though there be no rescission of the contract.

These doctrines have but little application to the contract between the members of a corporation. Every individual shareholder assumes the duties of the status into which he enters, and becomes entitled to have every other shareholder perform a similar undertaking in return. A shareholder cannot claim a release from the obligation of his contract, merely because some of the other shareholders have violated the charter and have failed to perform their engagements; because, if one member were discharged, it is clear that the contract of every other member would be impaired. It is the right of each individual shareholder to insist upon a specific performance of the contract of membership by every other member of the company.

§ 116. **Wrongful Acts of Agents no Ground for Rescission.** — It is evident that a wrongful act done by a third person, not a party to the contract of membership, cannot release any

City Bank v. Bruce, 17 N. Y. 507; ¹ See Holladay v. Elliott, 8 Oregon, 84.
Williams v. Savage Manuf. Co., 3 Md. Ch. 418; Taylor v. Miami Exporting Co., 6 Ohio, 177.

of the parties to that contract from the performance of the obligations which he has assumed. And therefore it is not a defence to an action against a shareholder for calls, to say that the agents of the company have exceeded their authority and have done unauthorized acts. If a shareholder is aggrieved by wrongful acts of the managing agents of the company, he has his remedy in equity, to preserve his interest in the common concern from harm, and to enforce a specific performance of the contract of membership.¹

In *Mississippi, &c. R. R. Co v. Cross*,² Chief Justice English said: "It may be safely announced as a general rule, that in a suit by a railroad company, or other corporation, against a subscriber, for assessments upon his stock, he is not permitted to show, by way of defence to the action, that the corporation has, by mis-user or non-user, violated or failed to comply with the provisions of its charter. . . . The charter is the law of the subscriber's contract. If the directors undertake to make an unwarrantable departure from the provision of the charter in the location or construction of the road, or in the appropriation of the funds of the company, the stockholder has his remedy by injunction. Not to enjoin the collection of calls due upon his stock, but to restrain the corporation from the particular violation or abuse of its charter complained of."

In *Hannibal, &c. Plank Road Co. v. Menefee*,³ a shareholder set up as a defence to an action for calls upon his stock, that the directors had violated the charter of the company, which required the construction of a plank road, by causing three miles of the road to be made of gravel; but the Supreme Court of Missouri held that the unlawful act of the directors did not release the shareholder from his obligation to the other shareholders. Richardson, J., said: "The directors are merely agents of the corporation. They do not own the stock subscribed, and cannot sue for it; and therefore a defence that might be made to a suit, brought in their

¹ *Infra*, §§ 237, 279.

² 20 Ark. 443, 451, 452.

³ 25 Mo. 547, 548. See also

Central Plank Road Co. v. Clemens,
16 Mo. 359.

names and for their personal benefit, would not be responsive to an action in the name of the corporation. This suit is in the corporate name of the company that represents all the stockholders, each one of whom is interested in the proper administration of the assets of the company; and the suit is practically for their benefit. The real question is whether a stockholder is discharged from the payment of his subscription and from his duty to bear the part he has assumed of a common burden with other stockholders, because his or their agents in some particular may transcend their authority.”¹

§ 117. **Cases where Rescission was denied.** — It has been held, accordingly, that a failure on the part of the agents of a corporation to manage its business in the manner required by its charter is not a defence in an action against a shareholder for the payment of his proportion of the capital.²

So, if the directors of a corporation attempt to release a portion of the shareholders and cancel their shares, this will not discharge the other shareholders from the obligation of their contracts; for such release and cancellation, being unauthorized, would not bind the corporation, and would be wholly void.³ Nor would it be a defence to an action for calls, that the agents of the company have received payment of a portion of the stock subscriptions in depreciated currency, or in an unauthorized manner. An unauthorized receipt of payment would not bind the corporation, and could not be set up as a defence in an action to enforce the shareholder's liability.⁴

¹ See also *Ex parte Booker*, 18 Ark. 338; *Hammett v. Little Rock, &c. R. R. Co.*, 20 Ark. 204; *Ottawa, &c. R. R. Co. v. Black*, 79 Ill. 262; *Hays v. Ottawa, &c. R. R. Co.*, 61 Ill. 422; *Chetlain v. Republic Life Ins. Co.*, 86 Ill. 220; *First Municipality v. Orleans Theatre Co.*, 2 Rob. (La.) 209; *Little v. O'Brien*, 9 Mass. 423; *Dorman v. Jacksonville, &c. Plank Road Co.*, 7 Fla. 265; *Smith v. Tallassee Branch R. Co.*, 30 Ala. 650; *Greenville, &c. R. R. Co. v. Johnson*, 8 Baxter,

332; *Buffalo, &c. R. R. Co. v. Gifford*, 87 N. Y. 294.

² *Hornaday v. Indiana, &c. Ry. Co.*, 9 Ind. 263; *Illinois Grand Trunk R. R. Co. v. Cook*, 29 Ill. 237; *Chetlain v. Republic Life Ins. Co.*, 86 Ill. 220.

³ *Whittlesey v. Frantz*, 74 N. Y. 456; *Jewett v. Valley Ry. Co.*, 34 Ohio St. 601; *Agriculturist Cattle Ins. Co. v. Fitzgerald*, 15 Jur. 489. Compare *Rensselaer, &c. Plank Road Co. v. Wetsel*, 21 Barb. 56.

⁴ *Phillips v. Covington, &c. Bridge*

An undue delay in the completion of the works of a company and in the prosecution of its business,¹ or even an entire failure of the enterprise for which the company was formed,² would not necessarily discharge a shareholder from his obligation to contribute a proportionate share of the company's capital. Creditors would be entitled to have the unpaid capital called in to satisfy their claims; and every shareholder would be entitled to have the losses suffered by the company distributed equally among all the shareholders.³

It is to be observed, however, that any failure of the enterprise of a corporation which would deprive the directors of the power of making calls, there being no unpaid creditors, might be a defence to an action against a shareholder, on the ground that the directors would have no authority to call in the capital of the company under those circumstances.⁴

§ 118. **Contracts to purchase Shares.**—In case of a contract for the future purchase of shares, the payment of the purchase money and delivery of certificates for paid up shares are conditions concurrent, and the purchaser would not become a shareholder until after the execution of the contract. If a corporation, after entering into a contract of this description, should, through the action of its agents, allow itself to be placed in such a position as to be unable to carry out substantially its part of the agreement, this would give the purchaser a sufficient reason for declining to perform the agreement on his part. Any serious mismanagement of the company's business which would practically destroy the value

Co., 2 Metc. (Ky.) 219, 223; *Maccon, &c. R. R. Co. v. Vason*, 57 Ga. 314; *Little v. O'Brien*, 9 Mass. 423.

¹ *Pickering v. Templeton*, 2 Mo. App. 424; *Miller v. Pittsburgh, &c. R. R. Co.*, 40 Pa. St. 237; *Gibson v. Columbia, &c. Turnpike, &c. Co.*, 18 Ohio St. 396.

² *Buffalo, &c. R. R. Co. v. Gifford*, 87 N. Y. 294; *Smith v. Gower*, 2 Duv. 17; *Hardy v. Merriweather*, 14 Ind. 203; *Bish v. Bradford*, 17

Ind. 490; *Morgan County v. Thomas*, 76 Ill. 120; *McMillan v. Maysville, &c. R. R. Co.*, 15 B. Monr. 218; *Four Mile Valley R. R. Co. v. Bailey*, 18 Ohio St. 208. Compare *Lake Ontario, &c. R. R. Co. v. Curtiss*, 80 N. Y. 219.

³ See *infra*, §§ 800, 311.

⁴ *Infra*, §§ 150-153. *McCully v. Pittsburgh, &c. R. R. Co.*, 32 Pa. St. 31; *Macedon, &c. Plank Road Co. v. Lapham*, 18 Barb. 315.

of its shares, as, for example, a large issue of fraudulent stock certificates, which would become binding upon the company in the hands of *bona fide* holders, would have this effect.¹

§ 119. **Rescission by Unanimous Consent under Legislative Authority.**—Under the prohibition of the Constitution of the United States against State legislation impairing the obligation of contracts, no State has the power to rescind or alter the contract existing between the shareholders of a corporation.² An attempted alteration of the charter of a corporation by a State law is therefore a mere nullity, and does not prevent a shareholder from obtaining an injunction to restrain the other corporators, or their agents, from violating the original contract.³

It is clear, however, that the shareholders of a corporation may by their unanimous agreement, with the consent of the State, rescind their mutual engagements; and any portion of the members of the dissolved company may, by entering into a new agreement between themselves, form a new corporate association. If, then, a portion of the shareholders of an existing corporation attempt to act under a new or altered charter, thereby showing an intention to rescind their first agreement, the other parties to the agreement may either enjoin them from violating their compact, or they may consent to treat the original contract as rescinded, and withdraw from the association altogether. Thus, in *Fry v. Lexington, &c. R. R. Co.*,⁴ it appeared that an amendment to the charter of a railroad company had been passed by the legislature, authorizing the company to consolidate with other corporations and to purchase shares in other undertakings. The Supreme Court of Kentucky held that, if the amendment was accepted by a portion of the company, and acted upon, the remainder of the shareholders might consider their membership at an end. Chief Justice Simpson said: "The charter of this road con-

¹ *Merrill v. Gamble*, 46 Iowa, 615; also *Lake Ontario, &c. R. R. Co. v. Merrill v. Beaver*, 46 Iowa, 646; *Merrill v. Reaver*, 50 Iowa, 404; *Court-right v. Deeds*, 37 Iowa, 504. See

Curtiss, 80 N. Y. 219.

² *Infra*, § 1027.

³ *Infra*, § 297.

⁴ 2 Metc. (Ky.) 314, 322.

tains no provision authorizing amendments to be made, nor was there any general law in force at the time it was granted by which they were authorized. The subscribers, therefore, who do not assent to the amendment, have the right, if they think proper to exercise it, to prevent the company from proceeding to act under the amended charter, and to compel it to confine its operations solely to the promotion of the objects designed to be accomplished by the original charter. Or they may waive this right, permit the company to proceed under the amended charter, and dissolve their connection with it upon equitable terms.”¹

The right to restrain a violation of the charter agreement does not exist where an alteration is imposed by the State in the exercise of its power of eminent domain. In such case a shareholder who does not consent to enter into the altered agreement must withdraw from the company upon receiving due compensation.² What acts constitute an alteration or violation of the charter agreement will be considered in detail in a subsequent chapter.³

§ 120. The rescission of the contract of membership, like its formation, can take place only through the agreement of

¹ See also *Middlesex Turnpike Co. v. Locke*, 8 Mass. 268; *Middlesex Turnpike Co. v. Swan*, 10 Mass. 384; *Union Locks Co. v. Towne*, 1 N. H. 44; *Indiana, &c. Turnpike Co. v. Phillips*, 2 P. & W. 196; *Southern Penn. Iron, &c. Co. v. Stevens*, 87 Pa. St. 190; *Ashton v. Burbank*, 2 Dill. (C. C.) 435; *Nugent v. Supervisors*, 19 Wall. 241, 248; *Buffalo, &c. R. R. Co. v. Pottle*, 23 Barb. 21; *Champion v. Memphis, &c. R. R. Co.*, 35 Miss. 692; *Hartford, &c. R. R. Co. v. Croswell*, 5 Hill, 383; *New Orleans, &c. R. R. Co. v. Harris*, 27 Miss. 519; *Hester v. Memphis, &c. R. R. Co.*, 32 Miss. 380; *Witter v. Mississippi, &c. R. R. Co.*, 20 Ark. 485; *Winter v. Muscogee R. R. Co.*, 11 Ga. 438; *McCray v. Junction*

R. R. Co., 9 Ind. 358, 359; *Booe v. Junction R. R. Co.*, 10 Ind. 93; *Aspinwall v. Ohio, &c. R. R. Co.*, 20 Ind. 492; *Shelbyville, &c. Turnpike Co. v. Barnes*, 42 Ind. 498; *Hughes v. Antietam Manuf. Co.*, 34 Md. 318; *Marietta, &c. R. R. Co. v. Elliott*, 10 Ohio St. 57; *Manheim, &c. Turnpike Co. v. Arndt*, 31 Pa. St. 317; *Fulton County v. Mississippi, &c. R. R. Co.*, 21 Ill. 338; *Troy, &c. R. R. Co. v. Kerr*, 17 Barb. 581; *Illinois Grand Trunk R. R. Co. v. Cook*, 29 Ill. 237; *Bank v. City of Charlotte*, 85 N. C. 433; *International, &c. R. R. Co. v. Bremond*, 53 Texas, 96. Compare *Pacific R. R. Co. v. Hughes*, 22 Mo. 291.

² *Infra*, § 1069.

³ *Infra*, §§ 395-407.

the corporators; the function of the legislature in altering a charter previously granted, as in granting a new one, is merely to legalize the voluntary acts of the corporators.¹ Hence the mere enactment of a law authorizing a corporation to act under a new charter, or to exercise new franchises, is not of itself an alteration or violation of the charter agreement which will enable a shareholder to consider his contract rescinded. It is merely a grant of authority to alter the charter, if the corporators choose to do so. Nor is it material that the act was passed at the request of a majority of the shareholders; for the latter may not desire to avail themselves of the new franchises until after the consent of all the shareholders has been obtained.²

The exercise of new privileges or franchises conferred by the State is not a ground for rescinding the contract of a shareholder, so long as there is no departure from the original charter agreement.³ It is clear that a person, who has subscribed for shares in a corporation after the company has accepted an amendment to its charter, cannot say that the amendment is in violation of his contract.⁴

§ 121. **Alteration effected by Legislation under a Reservation of Power to alter.**—If the power to alter or amend the charter of a corporation is expressly reserved by the terms of the grant, or by a general law under which the corporation was organized, the shareholders must be considered to have given their consent in advance to any alteration which the legislature may choose to impose. And it has been decided that,

¹ *Supra*, § 24.

² *Fry v. Lexington, &c. R. R. Co.*, 2 Metc. (Ky.) 314, 322; *Hawkins v. Mississippi, &c. R. R. Co.*, 35 Miss. 688; *Danbury, &c. R. R. Co. v. Wilson*, 22 Conn. 435; *Agricultural, &c. R. R. Co. v. Winchester*, 13 Allen, 32; *Peoria, &c. R. R. Co. v. Preston*, 35 Iowa, 125; *Rutland, &c. R. R. Co. v. Thrall*, 35 Vt. 536; *Clark v. Monongahela Nav. Co.*, 10 Watts, 364; *State v. Butler*, 13 Lea (Tenn.), 400, 404; *Del-*

aware, &c. R. R. Co. v. Irick, 3 Zab. 321. *Infra*, § 1063.

³ *Infra*, § 399; *Taggart v. Western Md. R. R. Co.*, 24 Md. 564; *Fry v. Lexington, &c. R. R. Co.*, 2 Metc. (Ky.) 321; *Poughkeepsie, &c. Plank Road Co. v. Griffin*, 24 N. Y. 150.

⁴ *Sparrow v. Evansville, &c. R. R. Co.*, 7 Ind. 369; *Hanna v. Cincinnati*, 20 Ind. 30; *Bish v. Johnson*, 21 Ind. 299; *Eppes v. Mississippi, &c. R. R. Co.*, 35 Ala. 54.

under a provision of this description, every shareholder must be considered to have invested the majority with a discretionary power to accept any alteration or amendment which may be *offered* by the legislature.¹ An alteration brought about in either manner is not a violation of the contract of the shareholders, and hence is not a ground for treating that contract as rescinded.² But the power to alter or amend the charter of a corporation does not imply a power to make a radical change in the company's purposes; this would be wholly unauthorized.³

Any alteration in the constitution or purposes of a company, which may be made in pursuance of a provision of the charter or general laws under which the company was organized, is not a departure from the original agreement of the shareholders, and hence is not a ground for rescinding the contracts of dissenting members. Thus, if the charter under which a railroad company was formed authorizes it to consolidate with other companies, no shareholder would have any right to object to a consolidation made in pursuance of this provision.⁴

§ 122. **The Power of declaring a Forfeiture of Shares.**—The members of a corporation may be compelled to contribute their respective shares of the capital stock by an action at law brought in the name of the corporation; and, at common law, this is the only remedy which can be resorted to. A corporation has no lien upon the shares of its members to secure the payment of assessments, unless it be expressly conferred by provision of the charter, by general statute, or by special

¹ *Infra*, §§ 404, 405, 1091.

² *New Haven, &c. R. R. Co. v. Chapman*, 38 Conn. 56; *Bish v. Johnson*, 21 Ind. 299; *Buffalo, &c. R. R. Co. v. Dudley*, 14 N. Y. 336; *Schenectady, &c. Plank Road Co. v. Thatcher*, 11 N. Y. 102; *Northern R. R. Co. v. Miller*, 10 Barb. 260; *Bucksport, &c. R. R. Co. v. Buck*, 68 Me. 81; *Pacific R. R. Co. v. Renshaw*, 18 Mo. 210; *South Bay, &c. Co. v. Gray*, 30 Me. 547.

See also *County of Scotland v. Thomas*, 94 U. S. 690; *County of Callaway v. Foster*, 93 U. S. 567. Compare *Witter v. Mississippi, &c. R. R. Co.*, 20 Ark. 490; *Mississippi, &c. R. R. Co. v. Gaster*, 24 Ark. 96.

³ *Infra*, § 1076.

⁴ *Infra*, § 407. *Nugent v. Supervisors*, 19 Wall. 241; *Atchison, &c. R. R. Co. v. Phillips County*, 25 Kans. 261.

agreement between the parties.¹ Nor can the shares of a member be declared forfeited and sold by the agents of the company for non-payment of assessments, except by virtue of an express grant of authority.² Even the holders of a majority of shares in a corporation have no implied authority to bind the minority through a by-law providing for a forfeiture and sale of the shares of those members who fail to contribute their proportion of the capital; there must be an express grant of authority.³

The power of forfeiture depends upon the consent of the shareholders; and therefore a forfeiture can be declared by a corporation in a foreign State only if authorized by the charter or the general laws under which the company was formed.⁴

§ 123. **Provisions conferring the Power of Forfeiture.**—In many instances, however, it has been provided in charters and general incorporation laws that the shares of a stockholder may be declared forfeited and sold for non-payment of assessments. A power of this character must be construed strictly, and the validity of a forfeiture and sale of the shares of a member depends upon a strict compliance with the formalities prescribed.⁵ A valid forfeiture can take place only by action of the legally appointed agents of the company having the requisite authority under the charter. Thus, where it was provided by statute that the shares of a member

¹ *Williams v. Lowe*, 4 Neb. 398; *Sargent v. Franklin Ins. Co.*, 8 Pick. 90; *infra*, § 201.

² *Williams v. Lowe*, 4 Neb. 382; *Ex parte Barton*, 28 L. J. Ch. 637; s. c. 5 Jurist, N. s. 420; *Perrin v. Granger*, 30 Vt. 595.

³ *Re Long Island R. R. Co.*, 19 Wend. 37; *Perrin v. Granger*, 30 Vt. 595.

⁴ *Mitchell v. Vermont Copper Mining Co.*, 40 N. Y. Super. Ct. 406; 67 N. Y. 280.

⁵ *Germantown, &c. Ry. Co. v. Fitler*, 60 Pa. St. 124; *Lewey's*

Island R. R. Co. v. Bolton, 48 Me. 451; *Mitchell v. Vermont Copper Mining Co.*, 40 N. Y. Super. Ct. 406; *Eastern Plank Road Co. v. Vaughan*, 20 Barb. 157; *Downing v. Potts*, 3 Zab. 66, 79; *Garden Gully, &c. Mining Co. v. McLister*, L. R. 1 App. Cas. 39; *Clarke v. Hart*, 6 H. L. C. 633. Compare *Knight's Case*, L. R. 2 Ch. 321; *Woollaston's Case*, 4 De G. & J. 437; *Johnson v. Albany, &c. R. R. Co.*, 40 How. Pr. 193; *Rutland, &c. R. R. Co. v. Thrall*, 35 Vt. 536; *Perrin v. Granger*, 30 Vt. 595.

might, upon failure to pay assessments, be sold at auction under an order from *the directors* to the treasurer, it was held that a sale made by the treasurer under the authority of a *committee* appointed by the directors was unauthorized and void; nor could a sale be made validly under an order of the directors giving the treasurer discretionary powers to sell or to sue, but the order of the directors must be absolute.¹

If the charter of a corporation prescribes a certain notice to be given to delinquent shareholders before declaring a forfeiture of their shares, this requirement must be strictly complied with;² if a sale by public auction is required, a private sale will be void;³ and it is essential that the sale take place at the time and place indicated. A sale of the shares of a stockholder for non-payment of assessments is void if any one of the assessments was unauthorized;⁴ and if the amount due was tendered to the proper agent of the corporation before a sale for non-payment has actually taken place, a sale made afterwards will be unauthorized and void.⁵

§ 124. **Effect of Forfeiture on the Liability of the Shareholder.**—A grant of the power to declare a forfeiture of the shares of a member for non-payment of calls does not, by implication, exclude the common law remedy by suit at law; the remedy by forfeiture is cumulative, and the agents of the company may, at their discretion, proceed either by suit at law for the unpaid calls, or by forfeiture and sale of the delinquent member's shares.⁶

¹ York, &c. R. R. Co. v. Ritchie, 40 Me. 425; Garden Gully, &c. Mining Co. v. McLister, L. R. 1 App. Cas. 39.

² Lewey's Island R. R. Co. v. Bolton, 48 Me. 451; Hughes v. Antietam Manuf. Co., 34 Md. 317. Compare Knight's Case, L. R. 2 Ch. 321.

³ Lewey's Island R. R. Co. v. Bolton, 48 Me. 451.

⁴ Ibid.; Stoneham Branch R. R. Co. v. Gould, 2 Gray, 277.

⁵ Mitchell v. Vermont Copper Mining Co., 67 N. Y. 280, and 40

N. Y. Super. Ct. 406; Sweny v. Smith, L. R. 7 Eq. 324.

⁶ Hughes v. Antietam Manuf. Co., 34 Md. 317; Northern R. R. Co. v. Miller, 10 Barb. 268; Piscataqua Ferry Co. v. Jones, 39 N. H. 491; New Hampshire, &c. R. R. Co. v. Johnson, 30 N. H. 390; City Hotel v. Dickinson, 6 Gray, 586; Boston, &c. R. R. Co. v. Wellington, 113 Mass. 79; Klein v. Alton, &c. R. R. Co., 13 Ill. 514. See Canal Co. v. Sansom, 1 Binney, 70; and see cases *infra*, § 128.

However, both remedies cannot consistently be pursued at the same time. A forfeiture and sale of the shares of a stockholder operates as a rescission of the contract of membership, and wholly dissolves the delinquent member's connection with the company. He is not thereafter entitled to any of the privileges of membership, and ought not to be compelled to bear any of the burdens which are incidental to that position.¹

Nor would it be just to compel a shareholder, whose shares have been declared forfeited for non-payment of calls, to pay any portion of such calls remaining unpaid after giving credit for the amount realized by the sale of the shares. If the charter of a corporation simply authorizes a forfeiture and sale of the shares of a shareholder for non-payment of calls, and the agents of the company elect to pursue that remedy, the shareholder is discharged from liability for any calls remaining unpaid, although the shares may sell for less than the amount of the calls.² In *Ashton v. Burbank*³ it was held that a corporation which had exercised its power to forfeit the shares of a member for non-payment of a call could not afterwards recover upon a promissory note given to it by such member for a previous unpaid assessment upon his shares.

The liability of a shareholder ceases at the time when the forfeiture is complete, and his connection with the company has been severed. If the charter provides for a sale of the shares of a delinquent member, it is fair to presume that the latter would remain a member of the company until the shares have been finally disposed of; hence his liability would continue until that time, and he would have a corresponding right of redeeming his default.⁴

¹ *Mills v. Stewart*, 41 N. Y. 384; *Foundry, &c. Co. v. Hall*, 121 Mass. 272. *Allen v. Montgomery R. R. Co.*, 11 Ala. 437; and see the next section.

² *Small v. Herkimer Manuf., &c. Co.*, 2 N. Y. 330; *Northern R. R. Co. v. Miller*, 10 Barb. 260, 277; *Macon, &c. R. R. Co. v. Vason*, 57 Ga. 314; *Rutland, &c. R. R. Co. v. Thrall*, 35 Vt. 536; *Mechanics'*

³ *Ashton v. Burbank*, 2 Dill. (U. S. C. C.) 435, before Dillon and Nelson, JJ.

⁴ *Instone v. Frankfort Bridge Co.*, 2 Bibb, 576. Compare *Rutland, &c. R. R. Co. v. Thrall*, 35 Vt. 536; and see the following sections.

§ 125. The decisions of the courts are not all in harmony with the views expressed in the preceding section. In various cases¹ it has been held that a forfeiture and sale of shares for non-payment of calls is similar to the foreclosure of a mortgage or pledge given as security for a debt; and that the corporation would be entitled to recover the amount of the debt remaining unpaid after the security had been exhausted. This view, however, is founded on a false analogy, and subordinates substantial justice to the requirements of a barren technicality. The liability of a shareholder for unpaid calls is not in fact an ordinary indebtedness, like that of a borrower to his lender, though it is treated as a debt by the courts of law. It is a liability to contribute to the company's capital for the common benefit, and each shareholder retains an equitable interest in the fund thus raised, in proportion to the amount of his shares. A forfeiture and sale operate as a rescission of the contract of membership, and the expelled member is deprived both of his interest in the capital and of his right to claim a performance of the contract by the other members. It should be borne in mind, that the power of declaring a forfeiture of the shares of a member is intended as a remedy to be used against defaulting members, and not in their favor; and that, therefore, a forfeiture can take place only provided the shares have some value, notwithstanding the unpaid calls. The agents of a corporation are not authorized to declare a forfeiture of shares when this would be a benefit rather than a loss to the party in default; as where the debts of a corporation are in excess of its assets, excluding the capital not yet called in. In such case, the members of the company must bear the loss equally, and both creditors and shareholders are interested in preventing any member from escaping from his obligations through the formality of a forfeiture of his shares.² If, then, a valid forfeiture of shares can be effected only when the forfeiture would be a

¹ *Herkimer Manuf., &c. Co. v. Northern Ry. Co. v. Kennedy*, 4 Small, 21 Wend. 273, overruled Exch. 417.

² N. Y. 330. See *Carson v. Arctic Mining Co.*, 5 Mich. 288; *Great hope's Case*, L. R. 1 Ch. 169.

loss to the shareholder and a gain to the corporation, no injustice is done to the members of the company by holding that a forfeiture extinguishes the liability of the shareholder for unpaid calls. On the contrary, it would be unjust to the expelled member to deprive him of his shares, which were made valuable by his own contributions, and, in addition, to compel him to increase the capital of the company after his own interest in it has ceased. Thus, if a forfeiture were declared for non-payment of a call of ninety per cent, after ten per cent had been paid on the shares, the expelled shareholder would lose his shares, and still be obliged to pay ninety per cent of their amount into the company's treasury, giving credit for the value of the shares with ten per cent paid up.¹

If the charter confers a naked power of forfeiture and sale for non-payment of calls, the proper rule would seem to be to sever the defaulting shareholder's connection with the company upon such terms as are just and equitable both to the shareholder and the company. This would be in one of two ways: either the shares should be sold, paid up only to the extent of the amount actually paid on them, and subject to further calls for the remainder, and the whole proceeds of the sale, less the incidental expense, should be turned over to the former holder; or the shares should be sold with all the calls paid, and, after deducting from the price received the amount of calls which the former holder neglected to pay, the residue should be turned over to him.

Of course the equitable rule must yield to any express provision contained in the charter. In many instances the object of a power of forfeiture and sale is not merely to bring about a rescission of the contract of membership upon equitable terms, but to compel prompt payment of calls under penalty of a forfeiture of the shareholder's interest. Thus, the charter construed in the case of *Small v. Herkimer Manufacturing Co.*² declared that the shareholders should be liable to pay calls "under penalty of forfeiture to the company of

¹ See *Small v. Herkimer Manuf., &c. Co.*, 2 N. Y. 330, 338.

² *Small v. Herkimer Manuf., &c. Co.*, 2 N. Y. 330.

their shares and all previous payments made thereon." In other cases, it has been expressly provided by law, or by articles of agreement, that, if the shares of a delinquent member should not sell for an amount sufficient to pay the unpaid calls, he shall be liable to the corporation for the deficiency.¹

§ 126. **The Right of Redemption.** — A shareholder may satisfy overdue calls upon his shares, and prevent a forfeiture, at any time before the proceedings to obtain a forfeiture are complete, and he has ceased to be a member of the company. Thus, if the charter provides that the shares of a defaulting member shall be declared forfeited and be sold to pay the unpaid calls, the holder's connection with the company would not ordinarily be deemed severed and the forfeiture complete until after a sale had taken place and a new party become invested with the shares. Hence, the owner would be entitled to pay the calls and discharge the default at any time before the shares were actually sold;² but after a sale had taken place, it would be impossible to reinstate the owner in his rights, and therefore no right of redemption could exist.

The right to redeem shares after a final forfeiture for non-payment of calls has usually been denied, even where the entire interest of the holder becomes vested in the company, without regard to its value or the amount of the calls remaining unpaid. Thus, in *Sparks v. Liverpool Water Works Co.*,³ a member of an incorporated water-works company brought a bill for relief against a forfeiture of his shares, which had occurred without his knowledge through accidental circumstances, but relief was denied. The Master of the Rolls said: "The parties might contract upon any terms they thought fit, and might impose terms as arbitrary as they pleased. It is essential to such transactions. This struck me as not like

¹ See *Danbury, &c. R. R. Co. v. Super. Ct. 406; Instone v. Frank-*
Wilson, 22 Conn. 436, 456; Stock-
en's Case, L. R. 5 Eq. 6. Compare
Athol, &c. R. R. Co. v. Prescott,
110 Mass. 213.
Northern Ry. Co. v. Kennedy, 4
Exch. 417.

² *Mitchell v. Vermont Copper*
Mining Co., 67 N. Y. 280; 40 N. Y.
³ *Sparks v. Liverpool Water*
Works Co., 13 Ves. Jr. 428, 434.

the case of individuals. If this species of equity is open to the parties engaged in these undertakings, they could not be carried on. It is essential that the money should be paid, and that they should know what is their situation. Interest is not an adequate compensation, even among individuals; much less in these undertakings. In particular cases interest might be compensation, but in the majority of cases it is no compensation, from the uncertainty in which they may be left. The effect is the same whether money has been paid or not. They know the consequence. The party making default is no longer a member."

A similar rule has been laid down by other eminent authorities.¹

§ 127. In *Walker v. Ogden*,² a former shareholder in a joint-stock company sought to redeem his shares, which had been declared forfeited for non-payment of calls. The articles of agreement provided that, if any shareholder should fail to pay assessments at the time specified, he should thereby forfeit all his shares, right, and interest in the association, and such forfeited shares should be distributed among the other shareholders who were not in default. The court granted relief by ordering that, upon payment of the whole amount due, principal and interest, the complainant should be allowed to redeem his stock, and certificates therefor should be executed and delivered to him by the company. Drummond, J., said: "The articles provide no express mode by which the forfeiture is to be established. If they did, and such mode had been pursued, and especially if any right had vested, in consequence thereof, in third parties, the defendant's argument would have had more force. But here is a mere naked declaration that the stock is forfeited, which is all that stands in the way of the relief sought by the bill. . . . The question is, Can the mere declaration of the trustees have the effect to foreclose all Walker's interest in this property? I think not.

* 1 *Germantown, &c. Ry. Co. v. low v. Dutch Rhenish R. R. Co.*,
 Fitler, 60 Pa. St. 124; Story on Eq. 21 Beav. 43.
 Jur. § 1325; *Prendergast v. Turton*, 2 *Walker v. Ogden*, 1 Biss. 287.
 1 Y. & C. N. R. 98, 110-112; Sud-

I am inclined to the opinion, (although I do not put my decision of this case on that ground,) that a judicial decree of foreclosure upon a bill filed by the trustees was necessary in order to bar the rights of Walker to redeem his stock."

It should be observed that *Walker v. Ogden* was a case of a voluntary joint-stock company, and that the effect of a forfeiture was considered solely in the light of the ordinary rules of equity jurisprudence. Where the power of forfeiture is conferred by charter, or by general law, the intention of the legislature would be of paramount importance.

Any negligence or delay would in any case deprive a delinquent shareholder of the right to redeem his shares, and this is especially true where the business of the company is of a speculative character.

CHAPTER III.

LIABILITY OF SHAREHOLDERS TO CONTRIBUTE CAPITAL.

§ 128. **The Character of the Liability.**— Every person who becomes a shareholder in a corporation, by subscribing for shares, agrees to associate with the other subscribers for the purposes, and upon the terms and conditions, indicated in the charter or constating instruments of the company.¹

If the charter or articles of association provide that each member of the company shall contribute a certain share of capital, this constitutes a part of the mutual agreement of the subscribers; and it is clear that every subscriber, in such case, becomes liable to pay in the amount of capital agreed upon. So, also, if the charter or constating instruments of a corporation provide that the capital stock of the company shall consist of a certain amount, to be divided into a given number of shares of a certain sum each, it is evidently intended that each shareholder shall contribute to the capital of the company in proportion to the number of shares he has taken. No other rational construction can be given to language of this description.

Hence it has been held that a person subscribing for shares in a corporation, whose charter or articles provide that each share shall consist of a certain amount, becomes liable, by virtue of his subscription, to contribute the amount of the shares he has subscribed to. No express promise to pay is required in the subscription itself, in order to create this liability. It is not a liability to pay *for* the shares taken; but it is a liability arising by virtue of the contract of membership. It is in many respects similar to the liability of a partner to

¹ *Supra*, §§ 43, 56.

contribute his share of the company's capital, as provided in the partnership articles.¹

This personal liability is not negatived by a provision in the charter authorizing the corporation to sell the stock of delinquent shareholders; the remedy by forfeiture is merely cumulative. And the corporation may, notwithstanding such provision, enforce the personal liability of its members to contribute the amount of capital which they have impliedly agreed to contribute.²

§ 129. **The Rule in Maine, Massachusetts, and New Hampshire.**—It seems surprising that so obviously reasonable a construction of the contract of a shareholder in a corporation should ever have been doubted. But an entirely different rule was established by judicial decisions in the States of Maine, New Hampshire, and Massachusetts. It was decided that a subscriber for shares of a specified amount each, in a corporation whose capital was fixed by the charter at a definite sum, did not impliedly undertake to contribute to the capital the amount of the shares subscribed by him, although he was constituted a shareholder in the corporation by virtue

¹ See cases in next note, and also *Upton v. Tribilcock*, 91 U. S. 45; *Webster v. Upton*, Id. 67; *Cole v. Ryan*, 52 Barb. 168; *Fry v. Lexington, &c. R. R. Co.*, 2 Metc. (Ky.) 316, 317.

² *Hartford & N. H. R. R. Co. v. Kennedy*, 12 Conn. 514–516, 523, 524; *Buffalo, &c. R. R. Co. v. Dudley*, 14 N. Y. 336; *Lake Ontario, &c. R. R. Co. v. Mason*, 16 N. Y. 451; *Rensselaer, &c. Plank Road Co. v. Barton*, Id. 457, note; *Northern R. R. Co. v. Miller*, 10 Barb. 260, and cases cited; *Troy, &c. R. R. Co. v. Tibbits*, 18 Barb. 297; *Dutchess Cotton Manuf. Co. v. Davis*, 14 Johns. 239; *Goshen, &c. Turnpike Co. v. Hurlin*, 9 Johns. 217; *Cheraw, &c. R. R. Co. v. White*, 14 S. C. 51; *Grosse Isle Hotel Co. v. Panson's Exrs.*, 42 N. J. L. 10; *Nulton*

v. Clayton, 54 Iowa, 425; *Waukon, &c. R. R. Co. v. Dwyer*, 49 Iowa, 121; *Kirksey v. Florida, &c. Plank Road Co.*, 7 Fla. 23; *Beene v. Cahawba, &c. R. R. Co.*, 3 Ala. 660; *Essex Bridge Co. v. Tuttle*, 2 Vt. 393; *Hughes v. Antietam Manuf. Co.*, 34 Md. 326; *Dexter, &c. Plank Road Co. v. Millerd*, 3 Mich. 91; *Carson v. Arctic Mining Co.*, 5 Mich. 288; *Instone v. Frankfort Bridge Co.*, 2 Bibb, 577; *Klein v. Alton & Sangamon R. R. Co.*, 13 Ill. 515; *Peoria, &c. R. R. Co. v. Elting*, 17 Ill. 429. Compare *Union Turnpike Co. v. Jenkins*, 1 Caines's Cas. 381; *Troy Turnpike, &c. Co. v. McChesney*, 21 Wend. 296; *Seymour v. Sturgess*, 26 N. Y. 134; *Fort Edward, &c. Plank Road Co. v. Payne*, 17 Barb. 573.

of his subscription; and that, in the absence of an express promise to pay for the shares, the subscriber incurred no personal liability, although the corporation was authorized by the charter to declare a forfeiture and sell the shares for non-payment of assessments.¹

In *Atlantic Cotton Mills v. Abbott*,² an action was brought by a corporation against one of its shareholders to recover the amount of several assessments upon his shares. The company had been organized with a capital of \$1,350,000, divided into shares of \$1,000 each, and the defendant had in his subscription agreed to take five shares. In addition to this, the defendant had, prior to the incorporation of the company, agreed with other subscribers to take *and pay* for five shares in the company, which was then about to be formed, and it was provided that the capital of the company should be not less than \$1,500,000. The Supreme Court of Massachusetts held that the defendant could not be held liable upon his subscription made after organization, because it did not contain a promise *to pay* for the shares; and that he was not liable upon the promise to pay made before organization, because that promise was upon condition that the whole number of shares then agreed upon should be taken, while the subscription in fact did not exceed \$1,350,000.³ Chief Justice Shaw said: "It is to be recollected that the promise of the defendant to pay assessments on shares is collateral to his subscription, and is relied on as creating an obligation over and beyond that which arises by law from his taking shares. If it imposes such obligation, it is by force of the express promise only; and if such promise is conditional, the condition must be strictly complied with. . . . But it is urged, that, by taking five shares after the capital was fixed at \$1,350,000, he waived the condition of making it depend

¹ *Belfast, &c. Ry. Co. v. Moore*, 60 Me. 561; *Central R. R. Co. v. Johnson*, 66 N.H. 390.

² *Atlantic Cotton Mills v. Abbott*, 9 Cush. 423.

³ See *infra*, § 137.

⁴ *Buckfield Branch R. R. Co. v. Irish*, 39 Me. 44. See also *New Hampshire*

on \$1,500,000. But let us ask, What condition? So far as the subscription paper operated as a promise, honorary or otherwise, to take \$5,000 in stock not less than \$1,500,000, his taking the same amount in a stock of \$1,350,000 was a waiver of the condition on which such engagement *to take* was founded. But the promise *to pay* was collateral, and not incident to the taking of shares; and therefore taking shares in another and smaller capital was not a waiver of the condition on which the promise to pay for shares in a larger stock was made."¹

This reasoning of the learned judge cannot be reconciled with a proper conception of the nature of a subscription for shares and the contract of a shareholder. A subscription for shares is in no sense an agreement to buy shares and pay for them.² The subscriber becomes a shareholder immediately and is entitled to the rights of a shareholder; it is a necessary implication that he also assumes the obligations of a shareholder. No reasonable man could expect to become a member of a corporation, and share in the common enterprise, without contributing, or undertaking to contribute, his proportionate part of the capital; nor can it be supposed that any reasonable man having shares in a corporation would consent to become associated with other shareholders on other terms.

It should be observed that the decisions above referred to appear to have been based originally on the supposed authority of *Andover, &c. Turnpike Co. v. Gould*, and similar cases, which were not in point, because in those cases the capital of the company and the amount of each share had not been fixed by the charter.

§ 130. **The Liability of the Stockholders where no Capital has been agreed upon.**—If the charter of a corporation does not expressly or impliedly provide that a certain amount of capital shall be contributed by its members for their common benefit, a person becoming a member of the association can-

¹ *Atlantic Cotton Mills v. Abbott*, *tama Land Co. v. Jernegan*, 126 9 Cush. 424; *Mechanics' Foundry*, Mass. 156.

&c. Co. v. Hall, 121 Mass. 272; Ka-² *Supra*, §§ 46, 61.

not be held to undertake to contribute anything. In such case, the majority or the directors of the company have no implied authority to make calls for capital upon the several members, and a subscriber can be held liable only by virtue of an express promise in the subscription itself. A provision in the charter that any shareholder who should decline to pay an assessment that was agreed upon by the majority should forfeit his shares to the extent of the assessment, could not reasonably be construed as imposing a personal liability.

This was the decision in *Andover, &c. Turnpike Co. v. Gould*.¹ A charter had been granted, on June 15, 1805, incorporating six persons named, and such others as might afterwards associate with them, for the purpose of building a turnpike road. The incorporators were invested with all the powers and privileges of the general act of 1804, c. 125, relating to turnpike corporations, and subjected to the regulations prescribed by it. The capital of the company was not limited by the charter or the general act to any certain sum, nor were the shares fixed at a definite amount or value.

Nor was there any express provision giving the agents of the company power to levy assessments upon the shareholders. The only provision upon this subject was in the tenth section of the general act, which provided, "that whenever any proprietor of a share or shares in any turnpike corporation hereafter established, shall neglect or refuse to pay any tax or assessment, duly voted and agreed on by such corporation, to their treasurer, within sixty days after the time set for the payment thereof, the treasurer of said corporation is hereby authorized to sell at public vendue the share or shares of such delinquent proprietor, sufficient to defray the said tax or assessment," &c. The defendant had subscribed for shares in the corporation, but had made no promise to pay assessments. An action of assumpsit having been brought for unpaid assessments, the Supreme Court of Massachusetts held that the defendant was not liable.²

¹ *Andover, &c. Turnpike Co. v. Gould*, 6 Mass. 40. the opinion, delivered by Chief Justice Parsons, seems to have been

² The decision, as appears from reached by the following course

§ 131. **Where the Liability has been exhausted.**—Upon the same principle, it follows that, after the liability of the shareholders to contribute the amount of capital agreed upon at the creation of the company has been exhausted, no further power to make calls or levy assessments can exist, unless provided by the express terms of the charter.¹

§ 132. **Where the Subscription contains an express Promise to pay.**—It has always been held that a subscriber for shares

of reasoning: The shareholders of a corporation are not at common law liable to pay assessments unless they are made liable by the terms of their charter. In the case before the court, the power to levy assessments was not expressly given, nor could such a power be implied from the nature and objects of the corporation. The only provision from which the power to levy assessments might be implied was the tenth section of the general act, which provided that the shares of delinquent proprietors might be sold, &c. "From this section," the court said, "we must conclude that the corporation have power to agree on a tax on the shares of the proprietors. But it is a rule, founded on sound reason, that when a statute gives a new power, and at the same time provides the means of executing it, those who claim the power can execute it in no other way. When we find a power in the plaintiffs to make the assessment, they can enforce the payment in the method directed by the statute, and not otherwise; and that method is by sale of the delinquent's shares. This rule applies to all taxes, public and private." Having thus arrived at the conclusion that the defendant was not liable to pay assessments by virtue of his membership in the corporation, the court held that the subscription paper itself, in which the subscribers

merely agreed to take the number of shares set against their names, was not evidence of an agreement to pay assessments levied on behalf of the corporation. To the same effect see *New Bedford, &c. Turnpike Co. v. Adams*, 8 Mass. 138. See also *Franklin Glass Co. v. White*, 14 Mass. 286; *Chester Glass Co. v. Dewey*, 16 Mass. 94; *Franklin Glass Co. v. Alexander*, 2 N. H. 380; *Odd Fellows' Hall Co. v. Glazier*, 5 Haringt. 172; *Bangor House Proprietary v. Hinckley*, 12 Me. 385.

The above cases were commented upon in *Essex Bridge Co. v. Tuttle*, 2 Vt. 393; *New Hampshire Central R. R. Co. v. Johnson*, 30 N. H. 390; *Kirksey v. Florida, &c. Plank R. Co.*, 7 Fla. 23; s. c. 68 Am. Dec. 426; *Hartford, &c. R. R. Co. v. Kennedy*, 12 Conn. 519-525.

¹ See *Atlantic Delaine Co. v. Mason*, 5 R. I. 463; *Great Falls, &c. R. R. Co. v. Copp*, 38 N. H. 124; *Kennebec, &c. R. R. Co. v. Kendall*, 31 Me. 470; *State v. Morristown Fire Ass.*, 3 Zab. 195; *Lewey's Island R. R. Co. v. Bolton*, 48 Me. 451.

In California, it was held by a divided court that the Code gave a right to assess shareholders after their shares have been paid up. *Santa Cruz R. R. Co. v. Spreckles*, 65 Cal. 193. Under a statute of Pennsylvania making shareholders

will be liable in an action to recover calls, if the subscription contains an express promise to pay the amount of the shares, although the charter expressly provides that the corporation may enforce payment by forfeiture and sale of the shares.¹

§ 133. **No Consideration required.**—It has sometimes been supposed that a consideration is necessary to support the promise of a shareholder to contribute the amount of his shares to the company's capital. This supposition seems to have its origin in the idea that a contract cannot, in the nature of things, exist without a consideration. But this idea is a mistaken one. The common law requirement of a consideration is merely a prerequisite imposed by positive law to the legal recognition and enforcement of an agreement not under seal; it is similar, in this respect, to the requirement of a deed to effect a conveyance of land, or of a writing under the Statute of Frauds. A subscription for shares, however, is not a common law contract. Its validity depends upon the charter or statute under which it is made;² and if the terms of the statute have been complied with, the subscription will be binding, although it might not be binding considered as a common law contract, by reason of the absence of legal consideration.

But if a consideration were necessary, abundant consideration may be found; for every subscriber assumes the burdens attaching to the position of shareholder, in consideration of obtaining the rights of a shareholder, and of a similar undertaking on the part of every other subscriber. In *Instone v. Frankfort Bridge Co.*,³ the Supreme Court of Kentucky held, that, in an action by a corporation against a subscriber for

liable to the amount of their shares, after they have been paid up at par, see *Price's Appeal*, 106 Pa. St. 421.

¹ *Boston, Barre, &c. R. R. Co. v. Wellington*, 113 Mass. 79; *City Hotel v. Dickinson*, 6 Gray, 586; *Taunton, &c. Turnpike Co. v. Whiting*, 10 Mass. 327; *Andover, &c. Turnpike Co. v. Gould*, 6 Mass. 40;

Worcester Turnpike Co. v. Willard, 5 Mass. 80; *Salem Mill Dam Co. v. Ropes*, 6 Pick. 23; *Buckfield Branch R. R. Co. v. Irish*, 39 Me. 44; *Stokes v. Lebanon, &c. Turnpike Co.*, 6 Humph. 241.

² *Supra*, § 56.

³ *Instone v. Frankfort Bridge Co.*, 2 Bibb, 576.

shares, it was sufficient to allege a subscription for shares according to the terms of the charter, and failure to pay after a call for payment had been made. Boyle, C. J., said: "By the subscription he became *ipso facto* a member of the association, and the rights and immunities which attached to him in that capacity constitute a sufficient consideration to impose upon him a legal obligation to pay according to the terms upon which the shares were authorized to be subscribed."¹

§ 134. This reasoning has no application in case of a contract to purchase shares or to become a shareholder in a corporation at a future time. A contract of this description is an ordinary common law contract, and is subject to all the technical rules governing common law contracts. The promise to pay for shares, and the corresponding promise to deliver them, or to receive the purchaser as a shareholder are concurrent, and each constitutes the consideration for the other. Without a consideration, neither promise would be binding.²

§ 135. **Subscribers do not become liable to contribute Capital until the Corporation has been formed.**—A subscription for shares of a certain amount each implies an agreement to contribute the amount of these shares to the capital of the company, for the purpose of carrying on its business; but the obligation to contribute the amount subscribed does not mature until the company has been incorporated, and invested by law with authority to carry on business in a corporate capacity. Hence, even although a subscription be binding from the time it was made,³ the subscriber cannot be called upon

¹ See also *Selma, &c. R. R. Co. v. Tipton*, 5 Ala. 787; *Kennebec, &c. R. R. Co. v. Palmer*, 34 Me. 366; *Hamilton, &c. Plank Road Co. v. Rice*, 7 Barb. 157; *Lake Ontario, &c. R. R. Co. v. Mason*, 16 N. Y. 463; *Ohio, &c. Female College v. Love's Exr.*, 16 Ohio St. 20; *Harlem Canal Co. v. Seixas*, 2 Hall, 504; *Fort Edward, &c. Plank Road Co. v. Payne*, 17 Barb. 572; *McCully v. Pittsburgh, &c. R. R. Co.*, 32 Pa. St. 31. Compare *Haskell v. Oak*, 75 Me. 519; *Conrad v. La Rue*, 52 Mich. 83.

² *Parker v. Northern Central, &c. R. R. Co.*, 33 Mich. 23; and see *supra*, § 61.

³ *Supra*, § 59.

to contribute his share of the capital until the corporation has actually been formed.

Thus, where the capital of a corporation is fixed by law at a certain sum, and the subscribers for shares do not become a corporate association until the whole capital has been subscribed, they cannot until then be compelled to contribute the amount of their shares.¹ So, also, where the performance of formalities is prescribed by law as a condition precedent to the right of the subscribers to form a corporation, they do not become liable to contribute the amount of their shares until these formalities have been performed.²

§ 136. Conditions expressly prescribed by Charter. — The contract between the members of a corporation is contained in the charter under which they have united themselves; and therefore, if any acts are required by the charter to be performed before the shareholders can be called upon to contribute the amount of capital agreed upon, the performance of these acts is a condition precedent to the liability of the shareholders upon their stock subscriptions. Thus, in an action against a subscriber for shares in a corporation whose charter provided that the president and directors (who were incorporated) should be authorized to make assessments upon the shareholders "when they shall have organized agreeably to this act," it was held by the Supreme Court of Alabama that an organization as provided by the act was a condition precedent to the liability of the shareholders to contribute any portion of the capital agreed upon. The court said: "The defendant, by his subscription of stock, admits nothing more than the charter of the company asserts; and if that contemplates some further act to be done before a requisition may be made upon the subscribers for payments upon their stock, or before they are liable to suit, that act must be shown to have been done. . . . To entitle the plaintiff to maintain an action against the defendant, and to recover the amount of calls made upon his stock, it should be shown

¹ Franklin Fire Ins. Co. v. Hart, 31 Md. 60.

² See *supra*, § 67; and *infra*, §§ 717-719.

that the meeting and election provided for by the charter did take place.”¹

§ 137. **Implied Conditions Precedent** — The Capital agreed upon must be subscribed. — The undertaking of the members of a corporation to contribute the amount of capital agreed upon is frequently, by its implied terms, subject to conditions precedent, which cannot be dispensed with except by mutual consent. Thus, it is a general principle that the members of a corporation cannot be required to pay assessments upon their shares until the company is authorized by law to begin the prosecution of its enterprise. Until that time the company can have no use for its capital, nor can there be any assurance that it will ever be required.

If the capital of a corporation is fixed by its charter at a certain amount, the company has no authority by law to begin the prosecution of its enterprise until the whole amount of capital has been subscribed;² and therefore a shareholder cannot be compelled to contribute his proportion of the capital before that time. In *Stoneham Branch R. R. Co. v. Gould*,³ Chief Justice Shaw said: “It is a rule of law too well settled to be now questioned, that when the capital stock and number of shares are fixed by the act of incorporation, or by any vote or by-law passed conformably to the act of incorporation, no assessment can be lawfully made on the share of any subscriber until the whole number of shares has been taken. This is no arbitrary rule; it is founded on a plain dictate of justice, and the strict principles regulating the obligation of contracts. When a man subscribes a share to a stock, to consist of one thousand shares, in order to carry on some designated enterprise, he binds himself to pay a thousandth part of the cost of such enterprise. If only five hundred are subscribed for, and he can have no assurance which he is bound to accept that the remainder will be taken, he would be held, if liable to assessment, to pay a

¹ *Carlisle v. Cahawba, &c. R. R. Co.*, 4 Ala. 76, *per* Collier, C. J. Compare *White Mountains R. R. Co. v. Eastman*, 34 N. H. 124.

² *Infra*, § 408.

³ *Stoneham Branch R. R. Co. v. Gould*, 2 Gray, 278.

five-hundredth part of the cost of the enterprise, besides incurring the risk of an entire failure of the enterprise itself, and the loss of the amount advanced towards it."

The same rule has been laid down in equally emphatic terms by the highest authorities throughout the United States and in England.¹

§ 138. **The Amount of Capital must be fixed.** — Under an act of incorporation providing that the capital of the company shall not exceed a certain amount, and shall be determined from time to time by the board of directors, no assessments can be laid upon a subscriber until the amount of the capital has been fixed.² If the charter of a corporation provides that its capital shall be not less than a certain amount nor exceed a given limit, but does not otherwise determine the exact amount, it is to be presumed that the legislature intended that the stockholders or the directors should fix the amount by their vote; and in such case it is indispensable that the amount be determined before any assessment can be levied.³ After the stockholders of a corporation have fixed the

¹ See *Bray v. Farwell*, 81 N. Y. 600, and *Peoria, &c. R. R. Co. v. Preston*, 35 Iowa, 118, 121, where the authorities are fully collected. Also *Salem Mill Dam Co. v. Ropes*, 6 Pick. 23, and 9 Pick. 187; *Cabot, &c. Bridge Co. v. Chapin*, 6 Cush. 50; *Hoagland v. Cincinnati, &c. R. R. Co.*, 18 Ind. 452; *Selma, &c. R. R. Co. v. Anderson*, 51 Miss. 829; *Hughes v. Antietam Manuf. Co.*, 34 Md. 332; *Livesey v. Omaha Hotel Co.*, 5 Neb. 50; *Topeka Bridge Co. v. Cummings*, 3 Kans. 55; *Shurtz v. Schoolcraft, &c. R. R. Co.*, 9 Mich. 269; *Swartwout v. Michigan Air Line R. R. Co.*, 24 Mich. 390; *New York, &c. R. R. Co. v. Hunt*, 39 Conn. 75; *Allman v. Havana, &c. R. R. Co.*, 88 Ill. 521; *Santa Cruz R. R. Co. v. Schwartz*, 53 Cal. 106; *Hale v. Sanborn*, 16 Neb. 1. See *Wontner v. Shairp*, 4 C. B. 404, 441;

Norwich, &c. Nav. Co. v. Theobald, 1 Moody & M. 151; *Pitchford v. Davis*, 5 M. & W. 2; *Fox v. Clifton*, 6 Bing. 776; *Wordsworth on Joint Stock Companies*, 318; *Lindley on Partnership* (4th ed.), 626. Compare *Waterford, &c. Ry. Co. v. Dalbiac*, 6 Eng. Ry. Cas. 753.

² *Troy & Greenfield R. R. Co. v. Newton*, 8 Gray, 596; *Worcester, &c. R. R. Co. v. Hinds*, 8 Cush. 110.

After the amount has been fixed and subscribed, an assessment may be made. *City Hotel v. Dickinson*, 6 Gray, 586, 588; *Lexington, &c. R. R. Co. v. Chandler*, 13 Metc. (Mass.) 311.

³ *Somerset, &c. R. R. Co. v. Cushing*, 45 Me. 524; *Somerset R. R. Co. v. Clarke*, 61 Me. 384. Compare *White Mountains R. R. Co. v. Eastman*, 34 N. H. 124.

amount of its capital in pursuance of the provisions of their charter, it is clear that no assessment for the general purposes of the company can be made until the whole amount agreed upon has been subscribed.¹

A vote of the directors that the subscription books be closed on a certain day in effect fixes the company's capital at the amount then subscribed;² and if the time during which subscriptions may be received is limited by the charter, the amount of the company's capital becomes fixed through lapse of time prescribed.³

It is clear, however, that if a corporation is authorized by its charter to begin the prosecution of its main enterprise before the amount of its capital has been fixed at a sum certain, it may also make calls upon its shareholders to contribute the requisite capital for that purpose.⁴

§ 139. **Capital required to pay Preliminary Expenses.** — The general rule is, that whenever a corporation is authorized by its charter to enter into engagements or incur expenses, it may also call in from its shareholders the necessary amount of the capital which they have agreed to contribute. Hence, if a corporation has authority to organize and incur expenses for preliminary preparations before the whole amount of its capital has been subscribed, and before it may begin to carry on its business, the shareholders will be liable to pay calls made for that purpose, though they would not be liable to pay calls made for any other purpose. Thus, in *Central Turnpike Co. v. Valentine*,⁵ it was held that the directors of a turnpike company might properly make a call of two dollars on each share before the whole capital had been subscribed,

¹ *Littleton Manuf. Co. v. Parker*, 14 N. H. 543; *Contoocook Valley R. R. Co. v. Barker*, 32 N. H. 363; *Cabot, &c. Bridge Co. v. Chapin*, 6 Cush. 50; *Read v. Memphis Gay-oso Gas Co.*, 9 Heisk. (Tenn.) 545.

² *Lexington, &c. R. R. Co. v. Chandler*, 13 Metc. (Mass.) 311.

³ *Bucksport, &c. R. R. Co. v. Buck*, 65 Me. 536.

⁴ *Bucksport, &c. R. R. Co. v. Buck*, 65 Me. 536; *Penobscot, &c. R. R. Co. v. Dunn*, 39 Me. 587; *Penobscot, &c. R. R. Co. v. Bartlett*, 12 Gray, 244. See the next two sections.

⁵ *Central Turnpike Co. v. Valentine*, 10 Pick. 142; *Salem Mill Dam Co. v. Ropes*, 6 Pick. 23, 43; and see *infra*, § 409.

in order to provide for preliminary expenses in getting the company started, and in surveying and locating the road, but that a call of thirteen dollars per share for general purposes was unauthorized.

§ 140. **Where Corporation has Authority to begin Business with Part of Capital.** — The capital of a corporation is subscribed for the purpose of prosecuting the enterprise for which the company was formed. And therefore, if the company is authorized by the terms of its charter to begin operations after a certain amount of capital has been subscribed, this necessarily implies that the shareholders may from that time be required to pay the amount they have agreed to contribute for that purpose. Accordingly in *Boston, Barre, &c. R. R. Co. v. Wellington*,¹ it was decided that a subscriber for shares in a railroad corporation which was authorized by its charter to begin the construction of its road whenever a given number of shares had been taken, became liable to pay assessments as soon as the subscriptions had reached the prescribed number. Morton, J., said: "The provision that the corporation may commence the construction of the first section when two thousand shares are subscribed, by necessary implication gives the corporation the right to assess the shares when they reach the number thus fixed."

The rule applicable to corporations formed under the general incorporation act of New York, passed in 1848,² is peculiar. A corporation formed under this act is deemed in existence as soon as the certificate of incorporation has been filed by the incorporators, although there are no shareholders and no shares have been subscribed. The trustees named in the certificate of incorporation have authority to receive subscriptions for shares, or to sell the shares for money or property,

¹ *Boston, Barre, &c. R. R. Co. v. Road Co. v. Rice*, 7 Barb. 166; *Wellington*, 113 Mass. 79, 85. See also *Boston, &c. R. R. Co. v. Pearson*, 128 Mass. 445; *White Mountains R. R. Co. v. Eastman*, 34 N. H. 124, 145; *Schenectady, &c. Plank Road Co. v. Thatcher*, 11 N. Y. 107; *Hamilton, &c. Plank* *Willamette Freighting Co. v. Stan-*
nus, 4 Oreg. 261; *Oregon Central R. R. Co. v. Scoggin*, 3 Oreg. 161; *Hunt v. Kansas, &c. Bridge Co.*, 11 Kans. 412; *Railroad Co. v. White*, 10 S. Car. 155. *Infra*, § 410.

² Laws of 1848, chap. 40.

and to begin to carry on the company's business as soon as the company has been organized. The act, however, provides that one half the capital stock, fixed and limited, of a company formed under the act, shall be paid in within one year, and the other half within two years, from the incorporation of such company, or such corporation shall be dissolved.¹

§ 141. **The Capital must be subscribed in Good Faith and Unconditionally.** — Where it is necessary that a certain amount of capital shall be subscribed before the stockholders of a corporation can be called upon to pay assessments, the required amount must be subscribed absolutely, and not conditionally. A subscription on condition precedent is a mere offer, and the subscriber does not become a shareholder, or incur any liability, until after the condition has been performed, and the subscription accepted by the company.²

In *Central Turnpike Co. v. Valentine*,³ the Supreme Court of Massachusetts held that a corporation whose capital was fixed at a certain amount could not recover assessments from its members, without showing that the whole amount of its capital had been unconditionally subscribed. The court said: "The main ground on which we proceed in the present case is, that the subscriptions of several persons were upon a condition precedent: one subscribes if the road shall be made in such a place; another, if in another place. The plaintiffs must show that the conditions have either been complied with or waived. This has been suggested, but the burden is on the plaintiffs to prove it. We may suppose two different subscriptions which are contradictory. It is clear that both conditions cannot be performed, and that both subscribers should not be counted as shareholders."⁴

It is necessary, also, that the required amount of capital be subscribed by persons apparently able to pay the assessments which may be made upon their shares. Fictitious subscrip-

¹ Laws of 1848, ch. 40, § 10.

² *Supra*, § 78.

³ *Central Turnpike Co. v. Valentine*, 10 Pick. 142.

⁴ See also *New York, &c. R. R. Co. v. Hunt*, 39 Conn. 75. Compare

Ridgefield, &c. R. R. Co. v. Brush, 43 Conn. 86, 96; and see *Ticonic Water Power, &c. Co. v. Lang*, 63 Me. 480; *Troy, &c. R. R. Co. v. Newton*, 8 Gray, 596.

tions, or subscriptions made by persons unable to contribute their proportion of the capital, do not satisfy the requirement that the whole capital of a corporation shall be subscribed before its members can be assessed.¹ But if the required number of subscriptions has been obtained in good faith from persons apparently able to perform their duties as shareholders, it is no defence to an action against a shareholder that some of the subscribers have proved to be insolvent.²

§ 142. **Liability where Capital is increased.** — If a corporation is authorized by its charter to increase the amount of its capital stock, and an increase is voted, a subscriber for new shares will be liable to pay calls without regard to the amount of the new shares that have been taken. The reason of this is obvious. The corporation, having already begun business, would be entitled to continue its business whether the whole or only part of the new issue should be taken, and a subscriber would become a shareholder in a going concern immediately. The contribution of the new capital would therefore be required for the company's authorized business purposes.³

§ 143. **The Necessity of Calls.** — If the charter of a corporation provides that the shareholders shall pay in their shares of the capital when required by vote of the board of directors or other agents of the company, it is clear that the shareholders cannot be held liable until after a call or assessment has been made. This is the rule even where there is no express provision in the charter or contract of subscription. It is an implied condition precedent to the liability of a subscriber to contribute to the company's capital, that a regular call or assessment shall have been made upon all the shareholders. The subscriber's liability does not mature until a call or assessment has been made. Until that time he can-

¹ *Lewey's Island R. R. Co. v. 187; Ridgefield, &c. R. R. Co. v. Bolton*, 48 Me. 451; *Phillips v. Covington, &c. Bridge Co.*, 2 Metc. (Ky.) 219.

² *Penobscot R. R. Co. v. Dummer*, 40 Me. 172; *Penobscot R. R. Co. v. White*, 41 Me. 512; *Salem Mill Dam Co. v. Ropes*, 9 Pick.

³ *Nutter v. Lexington, &c. R. R. Co.*, 6 Gray, 85; *Clarke v. Thomas*, 34 Ohio St. 46. Compare, however, *Read v. Memphis Gayoso Gas Co.*, 9 Heisk. (Tenn.) 545.

not be sued by the company,¹ nor can he be garnisheed at the suit of a creditor of the company.² Whatever the creditor's rights may be in equity, he cannot treat the stockholder's liability as a debt until after a call has been made. It follows, for the same reason, that a corporation cannot in a suit brought by a shareholder set off any portion of his stock liability until after a regular call has been voted.³ After a regular call has been made, the liability of the shareholder becomes a legal debt, and may be assigned by the corporation, like any other debt.⁴

§ 144. However, as a subscriber for shares impliedly agrees to pay the amount of his shares according to the charter or articles of association of the company, it is evident that, if the charter or articles provide that the shares shall be payable at certain settled periods, no call is required, and the subscriber is liable absolutely to pay at the times indicated.⁵ Upon this principle it has been held that a subscriber for shares in a corporation organized under a law which provided that the whole capital should be paid in within two years, or the company be dissolved, became liable to pay absolutely within two years, or at such previous time as the directors might require, and that after two years had elapsed an action might be brought against a stockholder without averring that a call had been made.⁶

If a shareholder has, by the express terms of his subscription, agreed to pay the amount of his shares immediately, or at certain stated times, it is clear that no further call is necessary, and he will be liable to pay according to the terms of the subscription.⁷

¹ *Grosse Isle Hotel Co v. Panson's Exrs.*, 42 N. J. L. 10.

² *Parks v. Heman*, 7 Mo. App. 14; *Pike v. Bangor, &c. R. R. Co.* 68 Me. 445; *infra*, § 799.

³ *Bouton v. Dry Dock, &c. Stage Co.*, 4 E. D. Smith, 420.

⁴ *Wells v. Rodgers*, 50 Mich. 294. *Infra*, § 799.

⁵ *Waukon, &c. R. R. Co. v. Dwyer*, 49 Iowa, 121.

⁶ *Phoenix Warehousing Co. v. Badger*, 67 N. Y. 294, 300; and see *Andrews v. Ohio & Miss. R. R. Co.*, 14 Ind. 169.

⁷ *Estell v. Knightstown, &c. Turnpike Co.*, 41 Ind. 174; *New Albany, &c. R. R. Co. v. Pickens*, 5 Ind. 247. Compare *Cheraw, &c. R. R. Co. v. Garland*, 14 S. C. 63; *Iowa, &c. R. R. Co. v. Perkins*, 28 Iowa, 281.

§ 145. **Who can make Calls.**—If the power of levying assessments is vested by the charter or articles of association of a company in particular agents, no other agents are impliedly authorized to exercise the power, and an assessment by the proper agents is a condition precedent to the liability of a shareholder. Thus, under a charter providing that calls shall be made by the board of directors, neither the president of the company nor a minority of the directors can make a valid call.¹

Nor can the power of making calls be delegated by the agents in whom it is vested by the charter. In *Silver Hook Road v. Greene*,² the court decided that the directors of a company could not delegate to the treasurer the power of making calls in such instalments as should be needed. It was held that the making of calls was a matter involving the exercise of judgment and discretion on the part of the directors themselves.³ A provision in a charter declaring that the corporation shall be authorized to levy assessments by vote,

¹ *Banet v. Alton & Sangamon R. R. Co.*, 13 Ill. 513; *Silver Hook Road v. Greene*, 12 R. I. 164; *Span- gler v. Indiana, &c. Ry. Co.*, 21 Ill. 276; *Price v. Grand Rapids, &c. R. R. Co.*, 13 Ind. 58; *Hamilton v. Grand Rapids, &c. R. R. Co.*, Id. 347; *Macon, &c. R. R. Co. v. Vason*, 57 Ga. 314; *Rutland, &c. R. R. Co. v. Thrall*, 35 Vt. 536; *Monmouth Mut. Fire Ins. Co. v. Lowell*, 59 Me. 504; *People's Mutual Ins. Co. v. Westcott*, 14 Gray, 440. Compare *Hays v. Pittsburgh, &c. R. R. Co.*, 38 Pa. St. 81.

² *Silver Hook Road v. Greene*, 12 R. I. 164; *Farmers' Mut. Fire Ins. Co. v. Chase*, 56 N. H. 341. Compare, however, *Rives v. Montgomery, &c. Plank Road Co.* 30 Ala. 92.

³ *Matteson, J.*, said: "If the making of calls involves the exercise of judgment and discretion, it follows that the vote of the directors authorizing the treasurer to call upon

the subscribers for the amounts subscribed, in such instalments as might be needed,—or, in other words, to exercise the discretion conferred upon them,—was a delegation of authority beyond their power to make; and the calls by the treasurer, in accordance with this vote, were invalid, and imposed no liability upon the defendant. Did the making of calls involve the exercise of judgment and discretion? We think so. It was the duty of the directors to make no calls till the interests of the corporation required it, to call for no greater instalments than might be needed, and to adjust the times of payment so as to cause as little inconvenience as possible to the subscribers. Certainly the proper determination of these various matters called for the exercise of judgment and discretion in a greater or less degree." 12 R. I. 164, 165.

places the power in the hands of the majority in stockholders' meeting; under such a provision, the directors and other agents of the company have no original authority to make assessments, and it seems that the power cannot be delegated to them by vote of the majority.¹

§ 146. If the directors of a corporation are authorized to require payments from the subscribers, at such times and in such proportions and on such conditions as they may see fit, they may either call at once for the whole amount of capital subscribed, or may divide it into instalments.² And it seems that, although it be expressly provided that assessments shall not exceed a certain sum on each share at one time, it is no objection that several assessments to the amount limited are voted at the same time, provided the shareholders be not required to pay more, at any one time, than the amount limited.³

§ 147. **Notice of Calls.** — The general rule is, that, in the absence of an express provision in the charter or articles of association of a corporation, requiring notice to be given to the shareholders after a call has been voted, no notice is necessary in order to hold the shareholders liable to pay the amount of the call; and it has been held that no demand is required before the institution of a suit.⁴

If the charter or articles of association provide that notice shall be given to the shareholders after a call has been voted, the giving of the prescribed notice is a condition precedent to

¹ *Ex parte Winsor*, 3 Story, 411. See *Louisiana Paper Co. v. Waples*, 3 Woods, 34; *infra*, § 516.

² *Haun v. Mulberry, &c. Gravel R. Co.* 33 Ind. 103.

³ See *Penobscot R. R. Co. v. Dummer*, 40 Me. 172; *Penobscot, &c. R. R. Co. v. Dunn*, 39 Me. 587; *Ambergate Ry. Co. v. Norcliffe*, 20 L. J. Ex. 234; *Ambergate Ry. Co. v. Mitchell*, 6 Eng. Ry. Cas. 234; *Rutland, &c. R. R. Co. v. Thrall*, 35 Vt. 536. Compare, however, *Spangler v. Indiana, &c. Ry. Co.*, 21 Ill. 276.

⁴ *Eppes v. Mississippi, &c. R. R.*

Co., 35 Ala. 33; *Lake Ontario, &c. Co. v. Mason*, 16 N. Y. 451; *Wilson v. Wills Valley R. R. Co.*, 33 Ga. 466; *Grubb v. Mahoning Nav. Co.* 14 Pa. St. 302; *Smith v. Indiana, &c. Ry. Co.*, 12 Ind. 61; *Eakright v. Logansport, &c. R. R. Co.*, 13 Ind. 404; *Fisher v. Evansville, &c. R. R. Co.*, 7 Ind. 407; *Ross v. Lafayette, &c. R. R. Co.*, 6 Ind. 297; *Peake v. Wabash R. R. Co.*, 18 Ill. 88; *Breedlove v. Martinsville, &c. R. R. Co.*, 12 Ind. 114; *Harlem Canal Co. v. Seixas*, 2 Hall, 504, 510.

the liability of the shareholders to pay the call.¹ But a provision directing notice to be given in a particular manner, as by letter or by publication, is not obligatory with respect to the particular method of giving the notice; actual notice, whether verbal or written, is in all cases sufficient, provided the shareholder be informed of the facts at the prescribed time.² Verbal notice is in all cases sufficient where no written notice is expressly required by the charter,³ and it has been held in Maryland that notice by publication in a newspaper is sufficient, where no particular kind of notice has been specified.⁴

§ 148. **Tender of Certificate unnecessary.**—A certificate of shares is not necessary in order to constitute a subscriber

¹ *Macon, &c. R. R. Co. v. Vason*, 57 Ga. 314; *Tomlin v. Tonica, &c. R. R. Co.*, 23 Ill. 429; *Lewey's Island R. R. Co. v. Bolton*, 48 Me. 451; *Miles v. Bough*, 3 Q. B. 845; *Newry, &c. Ry. Co. v. Edmunds*, 5 Eng. Ry. Cas. 275; *Cole v. Joliet Opera House Co.*, 79 Ill. 96; *Scarlett v. Academy of Music*, 43 Md. 203; and compare *Grubbs v. Vicksburg, &c. R. R. Co.*, 50 Ala. 398; *Mississippi, &c. R. R. Co. v. Gaster*, 20 Ark. 455; *Rutland, &c. R. R. Co. v. Thrall*, 35 Vt. 536.

² *Mississippi, &c. R. R. Co. v. Gaster*, 20 Ark. 455; *Lexington, &c. R. R. Co. v. Chandler*, 13 Metc. (Mass.) 311; *Jones v. Sisson*, 6 Gray, 288; *Danbury, &c. R. R. Co. v. Wilson*, 22 Conn. 435.

³ *Smith v. Tallassee Plank Road Co.*, 30 Ala. 650.

⁴ *Hall v. U. S. Ins. Co.*, 5 Gill, 484, 501. *Dorsey, J.*, said: "The act of Assembly provides for the subscription of ten thousand shares of stock. Amongst how many persons they may be distributed, not even a conjecture could be formed: they may have amounted to thousands. Of their respective resi-

dences there is equal, if not greater, uncertainty, the law making no provision for a registry thereof, which it certainly ought to have done, had such personal notice been deemed necessary. And there is no proportionate object attained for the great inconvenience, labor, and expense incident to such a notification, conceding it to be practicable. Persons who are stockholders in such a corporation are not inattentive to the concerns thereof, and obtain information in relation to its proceedings either through their own inquiries or the communications of friends resident at or near its office of business, or from publications in newspapers edited in its vicinity. The substitution of such newspaper publications in lieu of personal notice has so long been a universal usage, and of notoriety equal to that of the publication of newspapers themselves, that the custom of doing so has become a part of the law of the land." *Louisville, &c. Turnpike Co. v. Meriwether*, 5 B. Monr. 13; *contra*, *Lake Ontario, &c. R. R. Co. v. Mason*, 16 N. Y. 463; *Alabama, &c. R. R. Co. v. Rowley*, 9 Fla. 508.

upon the stock-books a shareholder and member of the corporation;¹ nor is the tender of a certificate necessary in order to enable a company to recover from its shareholders the amount of their subscriptions.²

§ 149. **Agreements to pay unconditionally.** — A shareholder may, by the express terms of his subscription, undertake to contribute the amount of his shares before the capital required to authorize the company to begin its operations and assess the other shareholders has been subscribed. Under these circumstances, the condition which would be implied in an ordinary subscription is superseded by the express terms of the subscriber's contract.³

The reasoning upon which some of the decisions cited in support of this obvious doctrine are based, is extremely unsatisfactory. The courts in Maine and Massachusetts start with the mistaken view that a subscriber does not become liable to contribute the amount of his shares by the terms of his contract of membership, but is liable, if at all, by reason of an express promise to pay for his shares.⁴ And in some cases, the radical difference between subscription upon a condition precedent, (being a mere offer to take shares,) and an absolute subscription upon special terms, appears to have been ignored.⁵ Thus, in *Bucksport, &c. R. R. Co. v. Buck*,⁶ a subscription was by its terms not to be binding "until the sum of one hundred thousand dollars shall have been subscribed by good and responsible parties." The court held that this,

¹ *Supra*, § 56.

² *Fulgam v. Macon, &c. R. R. Co.*, 44 Ga. 597; *South Georgia, &c. R. R. Co. v. Ayres*, 56 Ga. 234; *New Albany, &c. R. R. Co. v. McCormick*, 10 Ind. 499; *Vawter v. Ohio, &c. R. R. Co.*, 14 Ind. 174; *Heaston v. Cincinnati, &c. R. R. Co.*, 16 Ind. 275; *Smith v. Gower*, 2 Duv. (Ky.) 17; *Slipher v. Earhart*, 83 Ind. 173; and see cases *supra*, § 56.

³ *Iowa, &c. R. R. Co. v. Perkins*, 28 Iowa, 281; *St. Charles Manuf.*

Co. v. Britton, 2 Mo. App. 290; *Penobscot, &c. R. R. Co. v. Dunn*, 39 Me. 587; *Bucksport, &c. R. R. Co. v. Buck*, 65 Me. 536; *Kennebec, &c. R. R. Co. v. Jarvis*, 34 Me. 360; *Penobscot, &c. R. R. Co. v. Bartlett*, 12 Gray, 244; *Emmitt v. Springfield, &c. R. R. Co.*, 31 Ohio St. 23; *Lail v. Mt. Sterling Coal Road Co.*, 13 Bush, 32. Compare *People's Ferry Co. v. Balch*, 8 Gray, 303.

⁴ *Supra*, § 129.

⁵ *Supra*, §§ 78, 82.

⁶ 65 Me. 536, 539.

by necessary implication, meant that the subscription should be binding as soon as that amount should be obtained; and that, if the subscription was "binding," its payment could from that time be enforced.

The principles which are applicable to cases of this kind are in reality very simple. A subscriber in becoming a member of a corporation undertakes to contribute his proportionate part of the company's capital; but not immediately and at all events. He impliedly agrees to contribute his part only when the company shall have a use for its capital. If the company is not authorized to begin its main business until after a certain amount of capital has been subscribed, it would have no use for the bulk of its capital until that time. Hence in this case the subscription of the capital would be a condition precedent to the liability of the shareholder to contribute the amount of his shares. But it would not be a condition precedent to the subscriber's membership in the company, or the binding force of his contract. If a subscriber chooses to waive this condition to his liability, he may do so;¹ or he may bind himself by the express terms of his subscription to pay at a time fixed at all events.

§ 150. **Liability of Shareholders to pay unauthorized Calls.** — It is the duty of the directors of a corporation to call in its capital in such sums and at such times as they deem the interests of the whole association to require. The performance of this duty involves the exercise of a free discretionary power; and this power cannot be impaired by the shareholders, or restrained by a court, except in a clear case of bad faith on the part of the directors, or misapprehension of the principles which should govern their action. It is clear that a shareholder cannot refuse to pay a call upon the sole ground that it is injudicious, in his opinion, to require the company's capital to be paid in at that particular time.²

Opinions have been intimated that even where the making of a call is clearly unauthorized, and where the shareholders

¹ *Infra*, § 156.

² *Infra*, § 243. *Chouteau Ins. Co. v. Floyd*, 74 Mo. 286.

by the implied terms of their agreement are not liable to contribute the amount of their shares,—as, for example, where the prosecution of the enterprise in the manner agreed upon has become wholly impossible,—a shareholder cannot defend upon this ground in an action at law, but must seek relief in a court of chancery by injunction.¹ And it has been held by the Supreme Court of Indiana, that, in an action brought in the name of a corporation against its shareholders for payment of the amount of their shares, any irregularity or illegality in the election of the directors by whom calls were made is no ground on which the payment of the subscription for stock can be resisted, though it might be a ground for a *quo warranto* to oust the directors.²

These views cannot be supported upon sound principle. If the directors of a corporation threaten to make an unauthorized call, they may probably be restrained by injunction;³ and if the directors have not been regularly elected, *quo warranto* may be a proper remedy. But this is no reason why the shareholders should be compelled to contribute to the company's capital irrespective of the terms of their contract. The shareholders have agreed to contribute the amount of their shares only after an authorized call has been made by properly elected agents; and until such a call has been made, a condition precedent to their liability remains unperformed.

It has never been decided that shareholders are obliged to seek a remedy by injunction where a call is made before the required amount of capital has been subscribed;⁴ and numerous authorities hold that a call made by unauthorized parties, or in an unauthorized manner, may be disregarded by the shareholders.⁵ There is no reason why a different

¹ Salem Mill Dam Co. v. Ropes, Moore, 3 Ind. 510; *contra*, People's, &c. Ins. Co. v. Westcott, 14 Gray, 9 Pick. 196.

² Steinmetz v. Versailles, &c. Turnpike Co., 57 Ind. 457; Johnson v. Crawfordsville, &c. R. R. Co., 11 Ind. 280; Eakright v. Logansport, &c. R. R. Co., 13 Ind. 404; Covington, &c. Plank Road Co. v.

Moore, 3 Ind. 510; *contra*, People's, &c. Ins. Co. v. Westcott, 14 Gray, 440; and see *infra*, §§ 155, 620.

³ Illinois Grand Trunk R. R. Co. v. Cook, 29 Ill. 237.

⁴ *Supra*, § 137.

⁵ *Supra*, § 145.

rule should be applied in any case where a call is clearly unauthorized.

However, if the invalidity of a call does not appear clearly, there would be obvious advantage in requiring a shareholder to seek his remedy by injunction. Fairness demands that all shareholders should contribute in proportion to the amount of their shares, and if each shareholder were allowed to make his defence separately, there might be inconsistent decisions in a case of doubt. In a suit for an injunction it would be necessary to make the corporation a party, and the decision would determine the validity of the call as to all the shareholders, once for all.

§ 151. **Liability of the Shareholders after Abandonment of the Company's Enterprise.**—If the shareholders in a corporation have voluntarily abandoned the enterprise for the prosecution of which they agreed to unite, or if the further prosecution of the enterprise in the manner originally agreed upon has become impossible for any reason whatever, it is the duty of the company to its creditors to call in whatever capital may be required to settle up its affairs. And in such case every shareholder of the company, when called upon by the corporate agents, will be liable to contribute his proportionate part.¹

Thus, if a railroad company should become insolvent, and a mortgage upon its road be foreclosed, the shareholders would nevertheless remain to pay calls for the purpose of satisfying creditors.² The fact that a company's funds have been misappropriated and wasted, is no defence to a subsequent assessment, although the misappropriation may have caused the necessity of making a further assessment.³

§ 152. But after the enterprise of a corporation has been wholly abandoned, there can be no further use for its capital,

¹ *Phoenix Warehousing Co. v. Chouteau Ins. Co. v. Floyd*, 74 Mo. Badger, 67 N. Y. 294; 6 Hun, 286.

293; *Smith v. Gower*, 2 Duv. 17; ² *Buffalo, &c. R. R. Co. v. Gifford*, 87 N. Y. 294.

203; *McMillan v. Maysville*, ³ *Marshall v. Golden Fleece Mining Co.*, 15 B. Monr. 218; 16 Nev. 156.

except for the purpose of winding up the company's business; and if there are no unpaid creditors, the liability of a member of the company to contribute his share of the capital would, by the implied terms of his contract, have ceased. A shareholder undertakes to contribute the amount of his shares for no other purpose than to carry on the business for which the company was originally formed.

A by-law requiring the members of a corporation to pay assessments which are not necessary for any lawful or authorized purpose of the company is in excess of the powers of the directors, and therefore void.¹

Upon this principle, it was held by the Supreme Court of Pennsylvania, that, after a railroad company had wholly abandoned the construction of its road, and had released some of its members and refunded the money they had paid, every member was thereby discharged from liability to pay further calls. Woodward, J., said: "Not to say that the charter was forfeited by such inaction, it is very clear that subscribers were released. McCully's undertaking was not only *to* the company, but *with* the other subscribers. His subscription and theirs were mutual considerations for each other, and to let them off and hold him is to enforce a contract he never made. He has a right to insist that the company shall perform its charter duties in the time and manner prescribed, and that other subscriptions shall be enforced in the same manner as his own. And when the company let off part of its subscribers and returned them their money, without the consent of the defendant, actual or implied, they discharged him from all liability growing out of his original subscription. It was like a dissolution of a partnership, or an alteration in the fundamental law of an unincorporated society, or the substitution of new and incongruous objects of a corporation; in all of which cases the responsibilities of an original partner or subscriber cease."²

¹ *Hibernia Fire Engine Co. v. Commonwealth*, 93 Pa. St. 264; *London Tobacco Pipe Makers Co. v. Woodroffe*, 7 B. & C. 838. But the managing agents have a wide discretionary power to determine what amount of capital shall be called in for use in the company's business, or to accomplish any purpose authorized by the charter.

² *McCully v. Pittsburgh, &c. R. R. Co.*, 32 Pa. St. 32.

§ 153. **Distinction between Rescission of Contract and Cessation of Liability.** — There is a plain distinction between a rescission of the contract of membership and a cessation of the liability to contribute capital by reason of an implied condition in the shareholder's contract. A rescission implies a cancellation of the member's shares, and his complete withdrawal from the company. He thereby loses his entire interest in the company's assets, and becomes discharged from all further liability. This can take place only by agreement of the parties, with the consent of the legislature.¹ A departure from the charter without the consent of the legislature, or even an entire failure of the enterprise for which the company was formed, would not dissolve the corporation, or enable any shareholder to withdraw.² Every shareholder would retain his interest in the company's assets, and in the charter contract, and would be liable to contribute his share of capital, if needed for the payment of debts or for any legitimate purpose. The departure from the charter, or abandonment of the company's enterprise, would be a defence against calls only provided the shareholders' liability to contribute capital ceased, assuming their contract to be still in force.

Thus, if a railroad company should materially alter the line of its road, or consolidate with another company under a grant of legislative authority obtained for that purpose, any shareholder would be entitled to rescind his contract, and withdraw from the company. But if the alteration should be made without the consent of a shareholder, or in the absence of authority from the legislature, it would be in excess of the powers of the majority, or any of the agents of the company, and would not bind the company. A dissenting shareholder would be entitled to enjoin the unauthorized action, and he would have a right to refuse to pay calls made solely for the purpose of accomplishing the unauthorized alteration, for the reason that such calls would be in excess of the authority of the directors making them. But he would remain liable to pay calls made for authorized purposes. If the unlawful alteration or consolidation should be actually accomplished,

¹ *Supra*, §§ 109, 119.

² *Supra*, §§ 115, 116.

and the affairs of the corporation be placed thereby in such a position that it would be *impossible* to go back to the charter and carry on the company's business as originally contemplated, the only legal and proper course would be to wind up the company's business. Under these circumstances there would be no further use for contributions of capital by the shareholders, and the directors would have no authority to make further calls.¹

§ 154. **Calls must be Fair to all the Shareholders.** — Justice between the shareholders of a corporation requires that all the shareholders should contribute in respect of their shares at the same time and in ratable amounts; a call requiring some shareholders to pay in more than others would therefore be invalid.² But if some shareholders have already contributed more than others, it would be not only the right, but the duty, of the directors to make calls upon the other shareholders in such amounts as to equalize the contributions of all.

An accidental failure on the part of the directors to render a call binding upon every shareholder, by neglecting to send the required notices in individual cases, would not vitiate the entire call, but those who were properly notified would be liable. If, however, the directors should in bad faith neglect to notify some of the shareholders, or if for any reason the call should be unenforceable as against a large portion of the shareholders, and substantial injustice thus result, the entire call should be declared void, and a new one be made.

§ 155. **Unauthorized Calls cannot be ratified.** — The general rule is, that acts performed on behalf of a corporation without authority may be ratified and adopted by the company. By a fiction, the ratification of an act is held to cure the want of authority in the agent who performed it, and the act becomes binding upon the corporation to the same extent as if it had been originally authorized.

¹ See *South Georgia, &c. R. R. Co. v. Ayres*, 56 Ga. 230, 234; *Macedon, &c. Plank Road Co. v. Lap- ham*, 18 Barb. 315. ² *Infra*, §§ 302-315. *Pike v. Bangor, &c. R. R. Co.*, 68 Me. 445.

This rule has no application to unauthorized calls upon the shareholders. The necessity of making a call by the proper parties, and in the manner prescribed, arises from the terms of the shareholders' contract, and not from a limitation of the power delegated by the corporation to the parties making the call. The making of calls is not strictly speaking a corporate act. The shareholders have mutually agreed to contribute capital when certain persons shall have made a call in a certain manner and not before. The necessity of making a call as agreed upon cannot be obviated by the use of a fiction.¹

These views are in accordance with the principle acted upon in *Right v. Cuthell*,² and similar cases, in which it was held that a notice to quit given to a tenant of land, without authority, could not be ratified and adopted by the landlord. The tenant was entitled to a valid and binding notice, upon which he could act with certainty from the outset.

§ 156. **Waiver of Conditions Precedent.**—A stockholder may waive the performance of a condition precedent to his liability to contribute his proportionate share of the capital of the company; and after such waiver he will be liable as if the condition had been performed. Thus, it is an implied provision in the undertaking of a shareholder to contribute the amount of his shares, that the corporation shall have obtained the requisite amount of subscriptions, and shall have done all things required by law to authorize it to begin to carry on business.³ Yet if a subscriber, knowing that the requisite subscriptions had not been obtained, should attend meetings of the corporation and co-operate in votes for expending money and for making contracts, or take part in any

¹ In *Price v. Grand Rapids, &c. R. R. Co.*, 13 Ind. 58, an action was brought against a shareholder for non-payment of a call made by order of less than a quorum of the directors. An attempt was made to show that the order had been ratified "by the whole board and by the corporation in publishing the notice, bringing the suit, and by special demand."

The court held that the order of the minority was absolutely void, because there was a defect of power; and that, being void, it was not susceptible of ratification. Compare *Silver Hook Road v. Greene*; 12 R. I. 164; *Rutland, &c. R. R. Co. v. Thrall*, 35 Vt. 536.

² 5 East, 491.

³ *Supra*, § 137.

other acts which could be properly done only upon the assumption that the capital of the company had been fully subscribed, he would not be permitted to refuse to contribute his proportion of capital, upon the ground that the amount required by the charter had not been subscribed.¹

§ 157. For similar reasons, it follows that, if a shareholder should concur in the making of a call, he would not be allowed afterwards to object that the call was made in a manner or at a time not authorized by the charter of the association.² In *Cass v. Pittsburg, &c. Ry. Co.*,³ a shareholder was sued for the amount of ten calls, and endeavored to escape liability on the ground that he had not received the proper notice as prescribed by the charter. It appeared that, upon receiving notice of the second call, the defendant addressed a note to the secretary of the company, in which, after denying notice of the first call, he said: "I am not aware of being a stockholder, or of having subscribed to the stock of this corporation, and therefore your notice to me is in error." The Supreme Court of Pennsylvania held that the defendant was liable. Mr. Justice Sharswood said: "After this distinct and unequivocal repudiation of his subscription, it was no longer necessary to give him notice of the calls. It was a waiver of all notice, and operated in all respects as if the notices had been regularly given."

§ 158. **Proceedings to recover Calls.** — In an action brought by a corporation against a shareholder to recover the amount of a call, the plaintiff must allege and prove, both that the

¹ *Cabot, &c. Bridge Co. v. Chapin*, 6 Cush. 53; *Hughes v. Antietam Manuf. Co.*, 34 Md. 328, 329; *Hager v. Cleveland*, 36 Md. 476; *Bucksport, &c. R. R. Co. v. Buck*, 68 Me. 81; *New Hampshire Central R. R. Co. v. Johnson*, 30 N. H. 407. Compare *Oldtown, &c. R. R. Co. v. Veazie*, 39 Me. 571; *Hale v. Sanborn*, 16 Neb. 1.

² *Hays v. Pittsburgh, &c. R. R. Co.*, 38 Pa. St. 90, 91; *Winter v. Muscogee R. R. Co.*, 11 Ga. 438;

Schenectady, &c. Plank Road Co. v. Thatcher, 11 N. Y. 102; *Danbury, &c. R. R. Co. v. Wilson*, 22 Conn. 436; *Macon, &c. R. R. Co. v. Vason*, 57 Ga. 314; *Kansas City Hotel Co. v. Harris*, 51 Mo. 464; *Willamette Freighting Co. v. Stannus*, 4 Oreg. 261. Compare *Rutland, &c. R. R. Co. v. Thrall*, 35 Vt. 548; *Ossipee, &c. Manuf. Co. v. Canney*, 54 N. H. 295.

³ *Cass v. Pittsburg, &c. Ry. Co.*, 80 Pa. St. 31, 38.

defendant is a shareholder, and that all conditions precedent to his liability have been performed.¹

The fact that the defendant is a shareholder may be proven by the company's stock-books,² or by evidence of admissions of the defendant, or of acts estopping him from denying his membership. The subscription of the amount of capital necessary to be subscribed before the making of a call may be proven by the company's stock-books, properly identified; it is not necessary to prove the validity of the subscriptions by extrinsic evidence.³

The making of a proper call upon the shareholders may be proven in the usual manner of proving the proceedings of the board of directors,—by production of the minutes in connection with evidence showing that they are entries of the facts which happened.

Proof that notice of a call was given to the shareholders by publication,⁴ or by letter,⁵ may be made by any evidence, admissible according to established principles, from which the fact may be presumed.

The liability of the shareholders of a corporation to pay in the amount of capital subscribed by them is several and not joint;⁶ and where the same person subscribes more than once upon the subscription lists, it has been held that he may be sued separately upon each subscription.⁷

¹ *Fry v. Lexington, &c. R. R. Co.*, 14 Ind. 169; *Rutland, &c. R. R. Co. v. Thrall*, 35 Vt. 536.
² *Metc. (Ky.)* 314, 323, 324.

³ *Supra*, § 75. *Washer v. Allensville, &c. Turnpike Co.*, 81 Ind. 78.

⁴ *Supra*, § 75.

⁵ *Tomlin v. Tonica, &c. R. R. Co.*, 23 Ill. 429; *Unthank v. Henry*

County Turnpike Co., 6 Ind. 125; *Erie, &c. R. R. Co. v. Patrick*, 2 Keyes, 256.

Andrews v. Ohio & Miss. R. R. Co.,

⁶ *Jones v. Sisson*, 6 Gray, 288.
⁷ *Price v. Grand Rapids, &c. R. R. Co.*, 18 Ind. 137; *Herron v. Vance*,

17 Ind. 595.

CHAPTER IV.

TRANSFER OF SHARES.

§ 159. **The Effect of a Transfer of Shares.** — A transfer of shares in a corporation means the substitution of a new shareholder in place of an outgoing shareholder in the company, and an assumption by the former of all the rights and obligations which attached to the transferring shareholder by reason of his ownership of the shares. This involves a novation of the contract of membership. The transferor ceases to be a shareholder in the company. Unless the contrary be expressly provided in the company's charter, he is thus discharged from all further liability to contribute capital,¹ and loses all right to share in the company's profits and to participate in the management of its affairs.²

The transferee, on the other hand, becomes a shareholder in place of the retiring member. He impliedly assumes all the obligations which rested upon the former holder as member of the company, and is liable for calls to the same extent

¹ *Isham v. Buckingham*, 49 N. Y. 216; *Cole v. Ryan*, 52 Barb. 169; *Cowles v. Cromwell*, 25 Barb. 413; *Johnson v. Laffin*, 5 Dill. 65; *Chouteau Spring Co. v. Harris*, 20 Mo. 382; *Miller v. Great Republic Ins. Co.*, 50 Mo. 55; *Allen v. Montgomery R. R. Co.*, 11 Ala. 451; *Haynes v. Palmer*, 13 La. Ann. 240; *Huddersfield Canal Co. v. Buckley*, 7 T. R. 36; *Aylesbury Ry. Co. v. Mount*, 5 Scott's N. R. 127; *Weston's Case*, L. R. 4 Ch. 20; *Gilbert's Case*, L. R. 5 Ch. 559; *Wilson v. Birkenhead, &c. Ry. Co.*, 20 L. J. Exch. 306; *Harrison's Case*, L. R. 6 Ch. 286; *Murray v. Bush*, L. R. 6 H. L. 37; 6 Ch. 246; *Rivington's Case*, L. R. 3 Ch. Div. 10. Compare *Seymour v. Sturgess*, 26 N. Y. 134; *Gaff v. Flesher*, 33 Ohio St. 107; and see cases in the following notes, and *infra*, §§ 161, 838.

The transferor is discharged from liability to creditors as well as from liability to the company itself, unless the contrary be expressly provided. As to the liability of past members to creditors, under statutory provisions, see *infra*, §§ 839, 870.

² See cases in note 2, p. 160, and *infra*, §§ 162, 463.

as the former holder before the transfer was made.¹ He also becomes entitled to all the privileges of membership, and may claim all dividends declared while he is a shareholder in the company.²

§ 160. In those jurisdictions in which it is held that shareholders are not liable by the implied terms of their contracts of membership, and can be charged only if they have entered into a common law contract to pay for their shares, it would probably also be held that an assignee does not become liable to the company in the absence of an express agreement to that effect.³

In Pennsylvania, the rule appears to be established, by repeated decisions, that a transferor of shares does not become discharged from liability,⁴ and that the transferee assumes no liability to the company for subsequent calls.⁵

¹ Webster v. Upton, 91 U. S. 65; Pullman v. Upton, 96 U. S. 328; Moore v. Jones, 3 Woods, 53; Hartford, &c. R. R. Co. v. Boorman, 12 Conn. 530; Bend v. Susquehanna Bridge, &c. Co., 6 H. & J. 128; Hall v. U. S. Ins. Co., 5 Gill, 484; Mann v. Currie, 2 Barb. 294; Cole v. Ryan, 52 Barb. 168; Merrimac Mining Co. v. Bagley, 14 Mich. 501; Huddersfield Canal Co. v. Buckley, 7 T. R. 36; Cape's Ex'rs' Case, 2 De G., M. & G. 562; Holme's Case, 2 De G., M. & G. 113.

An assignee in bankruptcy of a shareholder does not become liable as a shareholder by force of the assignment in bankruptcy, nor does the estate become liable; but the assignee may become liable if he acts as a shareholder. American File Co. v. Garrett, 110 U. S. 295.

² March v. Eastern R. R. Co., 43 N. H. 515, 520; and see Goodwin v. Hardy, 57 Me. 143; Central R. R., &c. Co. v. Papot, 59 Ga. 342; Brundage v. Brundage, 65 Barb. 397; Hill v. Newichawanick Co., 48 How. Pr. 427; Kane v.

Bloodgood, 7 Johns. Ch. 90; Hague v. Dandeson, 2 Exch. 741; Jones v. Terre Haute, &c. R. R. Co., 57 N. Y. 196; 29 Barb. 353; Ryan v. Leavenworth, &c. Ry. Co., 21 Kans. 365, 403; Gifford v. Thompson, 115 Mass. 478; Boston, &c. R. R. Co. v. Commonwealth, 100 Mass. 399; Heath v. Erie Ry. Co., 8 Blatchf. C. C. 347; and see *infra*, § 162.

³ *Supra*, § 129.

⁴ Messersmith v. Sharon Savings Bank, 96 Pa. St. 440. Compare Merrimac Mining Co. v. Levy, 54 Pa. St. 227.

In Pittsburgh, &c. R. R. Co. v. Clarke, 29 Pa. St. 146, and Graff v. Pittsburgh, &c. R. R. Co., 31 Pa. St. 489, it was held that an original subscriber to the capital stock of a corporation formed under the general railroad act of Feb. 19, 1849, of the State of Pennsylvania, was not discharged from liability for the amount remaining unpaid upon his shares by transferring them to another.

⁵ Palmer v. Ridge Mining Co.,

§ 161. **The Liability for Calls as against the Corporation.**—In determining who is liable for unpaid calls upon shares which have been transferred, it is important to distinguish between the rights of the corporation as against the parties to the transfer, and the rights and liabilities of the transferor and transferee as between each other.

The general rule is, that, as between a company and its shareholders, a transferor is discharged from all liability on account of calls made after the execution of the transfer, and that the obligation to pay these calls falls upon the transferee.¹ It is usual to provide in the articles of association or by-laws of a corporation, that no transfer of shares shall be allowed until all unpaid calls shall have been satisfied.² But even where there is no provision of this kind, a shareholder cannot, by simply transferring his shares, deprive the company of its claim for overdue calls. After a call has been made, the company has a cause of action against the shareholder, and this cause of action cannot be extinguished except with the company's express consent. In *Schenectady, &c. Plank Road Co. v. Thatcher*,³ it was held that a shareholder who had transferred his shares to a solvent party was liable upon a call made before the transfer had been executed, although it did not become due and payable until afterwards.

It seems that a transferee of shares cannot be held liable upon a call made before he became a shareholder in the company.⁴ But a corporation is never obliged to treat shares as paid up until they have in fact been paid up. If shares are transferred after a call has been made, but before it has been paid, the transferor remains liable to the corporation, and the transferee cannot be charged *upon that call*. If the transferor should subsequently pay the call, the corporation would

34 Pa. St. 288; *Franks Oil Co. v. McCleary*, 63 Pa. St. 317; *Dela-ware, &c. Canal Co. v. Sansom*, 1 Binn. 70; *Messersmith v. Sharon Savings Bank*, 96 Pa. St. 440.

¹ *Supra*, § 159.

² *Infra*, § 201.

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³ *Schenectady, &c. Plank Road Co. v. Thatcher*, 11 N. Y. 102. Compare *North American, &c. Ass. v. Bentley*, 15 Jur. 187.

⁴ See *Aylesbury Ry. Co. v. Mount*, 4 Man. & Gr. 651; *Aylesbury Ry. Co. v. Thompson*, 2 Ry. Cas. 668.

be obliged to credit the shares with the amount paid, whoever may have become the holder of the shares. But if the call should remain unsatisfied and the shares not be paid up, the corporation would be entitled to make a new call upon the subsequent holder. These terms may undoubtedly be altered by express agreement with the corporation; and if the corporation should issue certificates declaring the shares to be paid up, a *bona fide* purchaser of the certificates would be entitled to become a shareholder, free from any further liability, whether the shares were in fact paid up or not.¹

The liability for unpaid calls as between the transferor and transferee of the shares depends wholly upon the agreement of the parties.²

§ 162. **The Right to Dividends.** — The right of a transferee of shares to dividends declared after the transfer was executed, but payable out of profits earned before that time, must be considered separately, as against the corporation and as against the transferor or vendor of the shares.

The general rule is, that, as between a corporation and its shareholders, those persons are entitled to dividends who are shareholders at the time the dividends are declared, irrespective of the time at which they were earned. This rule is based on reasons of convenience amounting almost to a necessity. It would be practically impossible to apportion the earnings of a corporation, whose shares are constantly changing hands, so as to give each holder a proportionate part of the profits earned while he was owner of the shares.³

It is important that the agents of a company should be able to determine, once for all, to whom they are under obligations to pay dividends which have been declared. Ordinarily, stock-books, showing who are the legal holders of shares, are provided for this purpose. And it is a general rule that a corporation may safely pay dividends to those

¹ *Infra*, § 816.

² See *infra*, §§ 175, 176.

³ Cases *supra*, § 159; and see *Hyatt v. Allen*, 56 N. Y. 553; *Boardman v. Lake Shore, &c. Ry.*

Co., 84 N. Y. 157; *Manning v. Quicksilver Mining Co.*, 24 Hun, 360; and cases cited in the following sections.

persons who are the legal holders of shares on the books of the company, at the time at which the dividends are declared, unless the company has notice of prior equities in third persons.¹

This rule applies whether the dividend be payable after the time at which the transfer is made or before. The persons who were shareholders at the time when the dividend was declared are entitled to receive it, at least as against the company, although they may have transferred the shares to other persons before the time at which payment became due. A corporation cannot require a person, who was a shareholder on the books when a dividend was declared, to produce his certificate before obtaining payment.²

It is to be observed, however, that the rule above stated does not determine the right to dividends as between the transferor and transferee of shares.³ A shareholder may undoubtedly sell his shares with or without accrued dividends; and there is no reason why he should not also by agreement retain a right to a dividend to be declared thereafter. A right thus obtained would be merely an equitable right, as against the company, like that of an assignee of a chose in action, and the company would therefore not be bound to recognize the assignee's rights unless notified thereof. But if notified of the assignee's rights, the dividend could not safely be paid to any other person.⁴

§ 163. **The Right to transfer Shares at Common Law.**—A contract or personal claim cannot, in the nature of things, be transferred like tangible property; the transfer of a contract right implies a novation, or, in other words, a release of the parties to the original agreement, and the formation of an exactly similar contract substituting a new party in place of one who retires. It is obvious that a transaction of this

¹ See *infra*, §§ 177, 181; *Brisbane v. Delaware, &c. R. R. Co.*, 25 Hun, 438; 94 N. Y. 204; *Cleveland, &c. R. R. Co. v. Robbins*, 35 Ohio St. 483; and cases cited in the following sections.

Hun, 459; affirmed 71 N. Y. 593. See *infra*, § 170.

² See *infra*, §§ 175, 177.

⁴ See *Manning v. Quicksilver Mining Co.*, 24 Hun, 360; and see *infra*, § 181.

³ *Hill v. Newichawanick Co.*, 8

description cannot take place without the mutual consent of the parties to the first agreement, as well as of those who enter into the new.

At common law, a novation can be effected only by means of an agreement directly between the parties themselves; and the obligation of a contract cannot be made transferable at the will of the obligee, even by express stipulation, except, by the custom of merchants, in case of negotiable paper. Hence shares in a copartnership or a joint-stock company cannot be made transferable without statutory authority; for a transfer of the shares would involve a novation of the contract between the shareholders.

It should be borne in mind, that a contract is binding at common law only between the parties who entered into it; and that an unaccepted offer is not binding at all, and may be withdrawn. The members of a partnership may undoubtedly enter into a contract, binding at common law as between themselves, that any member shall be entitled to transfer his shares, and that the transferee shall be received as a member in place of the outgoing member; but a contract of this kind would only be binding between the parties to it, and would not, *at law*, confer any rights or impose any obligations upon the transferee, or affect the legal rights of creditors.

It may perhaps be assumed that a contract between partners that their shares shall be transferable includes a continuing *offer* on the part of every partner to receive any transferee as partner upon the same terms as his transferor; and that the transferee accepts the offer by taking the shares, and thus enters into a contract directly with the other partners. This continuing offer to all purchasers of shares would, however, be revocable at any time before acceptance. Even if a novation of the contract between the partners could be brought about in this way, it would be impossible, upon any known principle of the common law, to substitute the transferee in the place of the outgoing partner with respect to third persons who have previously contracted with the company, except by obtaining their consent; and although all persons contracting with the company with notice of the

terms of the partnership articles might be held to have impliedly consented to any subsequent substitution of partners, this consent would create no privity with subsequent transferees of shares until accepted, and would be revocable until that time. The further objection arises, that the title to real estate held by the partners jointly could not be transferred to new parties by a simple transfer of shares.¹

These technical objections apply only to a transfer of the legal as distinguished from the equitable rights of partners. In equity any contract rights (unless of such a nature that they cannot possibly be enjoyed by any party except the party in whose favor they were created) may be assigned, in the absence of a statute. The legal right in this case remains in the transferor, but the beneficial interest is enforced in favor of the transferee as a trust.

The rights of the members of an ordinary business partnership are of a strictly personal nature; each partner contracts with the others in view of their character and special fitness or ability, and no member is authorized to withdraw in favor of a stranger. Hence shares in a partnership of this kind are not transferable at law or in equity.² If, however, the members of a common law partnership or company have agreed among themselves that their shares shall be transferable at will, only the technical reasons which have been pointed out would prevent a transfer from being recognized and given effect at law;³ and in this case a court of equity would enforce the transfer as a trust, according to the true intent of the parties.⁴

¹ See *Duvergier v. Fellows*, 5 Bing. 248, 267; *Blundell v. Winsor*, 8 Sim. 601, 612, 613.

² This refers to a transfer operating as a novation of the partnership contract, and not to a mere transfer of the partner's interest in the assets.

³ The rights of creditors who have dealt with the company without notice of the agreement that shares should be transferable, are

not considered here. Such creditors would be entitled to hold the outgoing partners liable, both at law and in equity.

⁴ See *Lovegrove v. Nelson*, 3 M. & K. 20; *Page v. Cox*, 10 Hare, 163.

A somewhat different view is expressed in *Lindley on Partnership* (4th Lond. ed.), 191, 699. The learned author says: "If partners choose to agree that any of

§ 164. **Shares in Corporations impliedly transferable by Statute.** — Corporations and joint stock companies organized under statutory provisions are governed by other rules. It is implied in the charter or articles of association of every company of this description, that the shareholders may transfer their shares at will, by simply giving notice of the transfer to the company, unless the contrary be expressly provided.¹ In this case, the consent of all the members of the company to the novation effected by the transfer is impliedly given in advance, and the objections which would apply at common law are obviated by force of the statute.

The managing agents of a corporation are impliedly authorized to make reasonable rules regulating the method of transferring shares. Thus, a by-law requiring a transfer to be entered upon the books of the company is valid.² But they cannot prohibit transfers entirely; and any unreasonable restriction upon the right of transfer will not be allowed. Thus, a majority of the shareholders of a corporation cannot, without express authority by the charter, pass a by-law, making the right to transfer shares depend upon the approval of the board of directors, or any other agent of the company.³

§ 165. **Agents of Corporation cannot prevent a Transfer.** — A provision in the charter of a corporation authorizing the board of directors "to regulate" transfers, does not give the directors the power to restrain transfers at their discretion, or to prescribe to whom they shall be made; it merely em-

them shall be at liberty to introduce any other persons into the partnership, there is no reason why they should not; nor why, having so agreed, they should not be bound by the agreement. Persons who enter into such an agreement consent prospectively and once for all to admit into partnership any person who is willing to take advantage of their agreement." This is quite true so far as the beneficial or equitable right goes, but, for technical reasons of the common law,

does not apply to the strictly legal rights.

¹ *Burrall v. Bushwick R. R. Co.*, 75 N. Y. 219; *Cole v. Ryan*, 52 Barb. 168; *Bank of Attica v. Manufacturers', &c. Bank*, 20 N. Y. 501.

² *Farmers', &c. Bank v. Wasson*, 48 Iowa, 339; *Chouteau Spring Co. v. Harris*, 20 Mo. 383; and see *infra*, § 472.

³ *Farmers', &c. Bank v. Wasson*, 48 Iowa, 339; *Sargent v. Franklin Ins. Co.*, 8 Pick. 90.

powers them to prescribe reasonable formalities to be observed in executing transfers. The same rule of construction applies to a provision in a charter that all transfers shall be registered by the board of directors, or that shares shall "be transferable only on the books of the company." A provision of this description does not confer upon the directors or transfer agents of the company a discretionary power to refuse to register a proposed transfer, although they should consider their refusal to be in the interest of the corporation. In *Johnson v. Laffin*,¹ a case arising under the national banking act, Dillon, J., said: "The purpose of requiring a transfer on the books of the bank is, that the bank may know who are the shareholders, and as such entitled to vote, receive dividends, etc., and for the protection of *bona fide* purchasers of the shares, and of creditors and persons dealing with the bank. That such is the meaning of the provision in question, and that it does not restrict the right of the owner to transfer his stock, or clothe the corporation with the power to refuse to register *bona fide* transfers, is settled beyond all question by numerous decisions in the English and the Federal and State courts. . . . No such power over the right of transfer has been given in the national banking act. Such a power is so capable of abuse, and so foreign to all received notions and the universal practice and mode of dealing in these stocks, that it cannot, in the absence of legislative expression, be held to exist."

If the charter or articles of association of a company expressly invest the directors with a discretionary power to approve or disapprove of transfers, they are not bound to state their reasons for disallowing a transfer; and if there is no evidence that the directors acted capriciously or unfairly, a court of equity will not interfere.² But the directors cannot withhold their consent to a transfer capriciously, and

¹ *Johnson v. Laffin*, 5 Dill. 75-78; *Chouteau Spring Co. v. Harris*, 20 Mo. 382; *Moore v. Bank of Commerce*, 52 Mo. 377; *Weston's Case*, L. R. 4 Ch. 20; *Gilbert's Case*, L. R. 5 Ch. 559.

² *Taft v. Harrison*, 10 Hare, 489; *Birmingham v. Sheridan*, 33 Beav. 660; *Shepherd's Case*, L. R. 2 Eq. 564; 2 Ch. 16.

without a sufficient reason ; the power of vetoing a transfer is reposed in the directors for the benefit of the whole association, and must be exercised by them fairly and in good faith, in accordance with their duty as trustees.¹

§ 166. *Transfer after Insolvency.* — *Rule in the United States.* — One of the most important features of a corporation, or statutory joint stock company, is the transferability of its shares. This power practically enables a person investing in a company of this kind to convert his shares into cash, and to withdraw at any time, without dissolving the company or reducing the amount of its capital.

But the right of transfer is agreed upon by the shareholders in a company solely for the purposes indicated ; it is not intended as a means of enabling particular shareholders to escape from bearing a share in the loss, if the enterprise should prove a failure, and to cast the entire loss upon the other associates. After a corporation has failed, every shareholder may claim that every other shareholder who was a party to the speculation and shared in the chances of success shall bear a proportionate part of the loss ; and a transfer of shares to an insolvent, or any other person unable to perform the obligations which rested upon the transferor, is unauthorized, and will not be allowed to prevail.²

This is the American rule, and, it is conceived, the correct one. To allow a shareholder to transfer his shares to an insolvent, for the purpose of escaping the liability to contribute in paying losses, after the company has failed, is not only unjust, but it extends the right of transfer entirely beyond the purposes for which it was conferred. After a corporation has become insolvent, it is the duty of the company to wind up its business, call in the outstanding capital, and satisfy creditors. The shares have ceased to be the subject

¹ Robinson v. Chartered Bank, L. R. 1 Eq. 32; Poole v. Middleton, 29 Beav. 646; *Re Stranton Iron, &c. Co.*, L. R. 16 Eq. 559; Pender v. Lushington, L. R. 6 Ch. D. 70; Penney's Case, L. R. 8 Ch. Ap. 446.

² Everhart v. West Chester, &c. R. R. Co., 28 Pa. St. 339; Chouteau Spring Co. v. Harris, 20 Mo. 382, 390; Johnson v. Laffin, 6 Cent. L. J. 131; 5 Dill. 76. As to the rights of creditors, see *infra*, § 838.

matter of legitimate traffic. They are a burden to the owner, and a transfer would be merely a subterfuge to avoid liability. Furthermore, it is the duty of the directors, the common agents of the shareholders, to call in whatever capital may be required to satisfy creditors, and to distribute the losses equally among the shareholders. If the directors neglect to perform this duty, no shareholder should be allowed to profit by it.

§ 167. **The Rule in England.**—A different rule has, however, been established in England under the Companies Acts. It is settled under these acts, that a shareholder may transfer his shares to an insolvent—a mere man of straw—for a nominal consideration, and with the sole purpose of escaping liability; and if such transfer was out and out, and not merely colorable, the transferor is discharged from all liability as a contributory, except under certain conditions to creditors as a past member.¹

§ 168. **Transfers after Dissolution.**—The right of a shareholder to transfer his shares necessarily ceases upon a dissolution of the corporation; for, after a dissolution, the contract of membership is at an end, and no further novation is possible. The interest of a shareholder in the assets of a corporation after its dissolution is a purely equitable claim, and an assignment of this interest will be recognized only by a court having jurisdiction in equity.²

§ 169. **Formalities must be observed.**—The articles of agreement, or laws, by which a corporation is formed, usually provide that shares in the company shall be transferable only in a particular manner, or upon particular conditions. A provision of this description constitutes a part of the agree-

¹ De Pass's Case, 4 De G. & J. Id. 296, note. Compare King's 544; Costello's Case, 2 De G., F. & Case, L. R. 6 Ch. 196; and see J. 302; Slater's Case, 35 Beav. 391; *infra*, § 839.

² James v. Woodruff, 10 Paige, 541; affirmed 2 Denio, 574. See Chappell's Case, L. R. 6 Ch. 902, 905; Allin's Case, L. R. 16 Eq. 449, 455. See *infra*, § 1011.

Garstin's Case, 10 W. R. 457; Hatton's Case, 8 Jur. n. s. 380; Weston's Case, L. R. 4 Ch. 20; Harrison's Case, L. R. 6 Ch. 286; Masters's Case, L. R. 7 Ch. 292; Hakim's Case, Id. 296, note; Bishop's Case,

ment between the shareholders; and the mutual consent necessary to a novation of this agreement cannot be implied unless the prescribed conditions have been fulfilled. A complete transfer of shares in a corporation, involving a novation of the contract of membership, can therefore be effected only in the manner prescribed by the charter or articles of association.¹ It follows, for this reason, that a transfer of shares in a foreign State must be made in accordance with the charter or general laws under which the corporation was formed.²

The rule above stated applies only to a transfer of existing shares, or substitution of shareholders, and not to a substitution of parties to a contract for the purchase of shares from the company issuing them, or, in other words, a contract to become a shareholder thereafter. A novation or alteration or rescission of a contract of this latter class may be accomplished in the same way as in case of any other common law contract.³

§ 170. **Registry of Transfers.**—The incorporating statutes, or articles of agreement, or by-laws, of corporations having transferable shares, in almost every instance provide that the shares shall be transferable only by entry upon the books of the company, and that a new certificate shall be issued to the transferee upon surrender of the outstanding certificate. The purpose of a provision of this kind is manifest. It is to provide the company and persons dealing with the company with the means of ascertaining who are its shareholders. If a transfer could be executed without an entry of the transfer upon the company's books, it would be practically impossible to know who are entitled to vote at meetings, to whom

¹ See *Northrop v. Newton, &c. v. St. Louis Mercantile Co.*, 9 Mo. Turnpike Co., 3 Conn. 544, *per* App. 133; *Fisher v. Essex Bank*, Hosmer, J.; *Union Bank v. Laird*, 5 Gray, 373; *Corden v. Universal* 2 Wheat. 390, *per* Story, J.; *Hibblewhite v. McMorine*, 6 M. & W. 200; *Merrill v. Call*, 15 Me. 428; *State v. Pettineli*, 10 Nev. 141. *Weyer v. Second Nat. Bank*, 57 Ind. 198; *Bishop v. Globe Co.*, 135 Mass. 132; *Bates v. Boston, &c. R. R. Co.*, 10 Allen, 251; *Stockwell*

² *Black v. Zacharie*. 3 How. 483.

³ Compare *supra*, § 110; *Morton's Case*, L. R. 16 Eq. 105; *Beresford's Case*, 2 McN. & G. 197.

dividends can be paid, and who are liable, as shareholders, to the company and to creditors. By requiring transfers to be registered, the company's books become a record showing who are its shareholders at any given time.

It follows, therefore, that a transfer upon the books is essential to a novation of the contract of membership, where there is a provision of this description. An assignment of shares, although valid as between assignor and assignee, would not affect their legal relationship to the company until after a transfer was entered upon the books, and the company would be entitled to treat the assignor as the absolute owner of the shares until notified of the rights of the assignee.

Accordingly, it has been held that an assignee of shares is not liable for calls until after a transfer has been executed in the manner prescribed, although the company have notice of the assignment;¹ nor is the assignor discharged from liability.²

Under similar circumstances, it was held that the assignee cannot, at law, recover dividends which had been declared by the company; for the assignee was not legally a shareholder in the company.³ Nor can a merely equitable assignee vote at corporate meetings; a regular transfer on the books is essential.⁴ A corporation is entirely justified in paying dividends to the persons standing on its books as

¹ Marlborough Manuf. Co. v. Smith, 2 Conn. 579. amount of payments which he has been compelled to make, see *infra*, §§ 175, 836, note.

² Dane v. Young, 61 Me. 160; Worrall v. Judson, 5 Barb. 210; Shellington v. Howland, 53 N. Y. 371; Humble v. Langston, 7 M. & W. 517; London, &c. Ry. Co. v. Fairclough, 2 Man. & Gr. 674; McEuen v. West London Wharves, &c. Co., L. R. 6 Ch. 655; Midland, &c. Ry. Co. v. Gordon, 16 M. & W. 804; s. c. 5 Eng. Ry. Cas. 76; Sayles v. Blane, 19 L. J. Q. B. 19; s. c. 6 Eng. Ry. Cas. 79. ³ Northrop v. Newton, &c. Turnpike Co., 3 Conn. 544; Oxford Turnpike Co. v. Bunnel, 6 Conn. 552. Compare Cleveland, &c. R. R. Co. v. Robbins, 35 Ohio St. 483; Hall v. Rose Hill, &c. Road Co., 70 Ill. 673; Chambersburg Ins. Co. v. Smith, 11 Pa. St. 120; Northrop v. Curtis, 5 Conn. 246. *Infra*, § 449.

⁴ *Infra*, § 463. Becher v. Wells Flouring Mill Co., 1 McCrary C. C. 62; People v. Robinson, 64 Cal. 373.

As to the right of the assignor to recover from the assignee the

shareholders, unless it has notice of prior equities in other persons; and it cannot, in the absence of a provision to the contrary in the charter or by-laws, require the persons who are shareholders by regular entry upon the books to produce their certificates before according them the rights of shareholders.¹

So, upon the dissolution of a corporation, its assets may safely be distributed among those who appear on the books to be shareholders in the company, unless certificate holders or merely equitable owners of shares have given notice of their rights.²

§ 171. **Assignment without Registry does not discharge Lien of Corporation.** — In *Union Bank v. Laird*,³ the Supreme Court of the United States held that a banking corporation, which by the terms of its charter had a lien upon the shares of its shareholders for debts due the bank, could not be deprived of this lien by an assignment which was not entered upon the books in the manner required by law. Justice Story said: "No person can acquire a legal title to any shares except under a regular transfer, according to the rules of the bank; and if any person takes an equitable assignment, it must be subject to the rights of the bank under the act of incorporation, of which he is bound to take notice." For similar reasons, it was held in *Indiana* that a corporation, could not claim a lien upon shares, on account of an indebtedness of a mere assignee, no transfer having been executed on the books, where the charter of the company gave it a lien for debts of its shareholders only. The court said: "Ownership, simply, of a certificate of stock in the bank, did not constitute the owner a stockholder. It required a transfer of the stock to him upon the books of the bank."⁴

¹ *Brisbane v. Delaware, &c. R. R. Co.*, 25 Hun, 438; *Cleveland, &c. R. R. Co. v. Robbins*, 35 Ohio St. 483. *Supra*, § 162.

² *Bank of Commerce's Appeal*, 73 Pa. St. 59.

³ *Union Bank v. Laird*, 2 Wheat. 390.

⁴ *Helm v. Swiggett*, 12 Ind. 194. But in *Planters', &c. Mutual Ins. Co. v. Selma Savings Bank*, 63 Ala. 585, it was held that the corporation would have an equitable lien as against the equitable holder.

§ 172. **How Transfer on Books executed.** — An assignment of shares, and power of attorney to execute a transfer on the books, need not be made under seal.¹ It seems that a sale or assignment of shares, which is intended by the parties to pass a complete title, is of itself an implied delegation of authority to both the vendor and the vendee to execute a complete transfer upon the books.² Where shares are transferable only “in person or by attorney” on the books of the company upon surrender of the certificate, the corporation is not bound to allow a transfer to be made, except by the owner in person or his duly authorized attorney.³ But under a provision requiring transfers to be executed on the company’s books, it is not necessary that the assignor should himself enter the transfer; the entry upon the books may be made by the officers of the company, on receiving proper evidence of the assignee’s right, and a surrender of the certificate issued to the assignor.⁴

A mere request upon the officers of a company to enter a transfer is not sufficient to constitute the transferee a shareholder, in the absence of an entry upon the books.⁵ But if a corporation is bound to receive a transferee, and the agents of the company in violation of their duty refuse or neglect to register the transfer, it is equitable to consider that done which ought to be done, and to regard the transfer as complete as against all persons except *bona fide* purchasers for value. It should certainly be so regarded as against the corporation.⁶

§ 173. **No new Certificate necessary to complete Transfer.** — A transfer of shares upon the books constitutes the transferee a shareholder, although no new certificate is issued. The certificate is merely the evidence of the holder’s rights.⁷

¹ Atkinson v. Atkinson, 8 Allen, 15.

² Webster v. Upton, 91 U. S. 65; Johnson v. Laffin, 5 Dill. 79, 80; 103 U. S. 800.

³ Mechanics’ Banking Ass. v. Mariposa Co., 3 Roberts. (N. Y.) 395; Purchase v. New York Exchange Bank, Id. 164.

⁴ Green Mount, &c. Turnpike Co. v. Bulla, 45 Ind. 1; Northrop v. Curtis, 5 Conn. 246.

⁵ Brown v. Adams, 5 Biss. 181.

⁶ *Infra*, § 222.

⁷ First National Bank v. Gifford, 47 Iowa, 575, 583; Hawley v. Upton, 102 U. S. 314.

§ 174. **Equitable Assignments of Shares.** — While the consent of both of the parties to a contract is necessary in order to effect a novation, yet either party may, without the consent of the other, assign to a stranger the right of enjoying his claims under the contract; and the interest of the assignee will be protected in equity as a trust, and may be enforced through the assignor.

This principle has been applied in case of an assignment of shares in a corporation. A novation of the contract of the shareholders can be effected only in the manner prescribed by the charter or by-laws, and an assignment of shares not executed in the manner required does not alter the relations existing between the assignor and the other members of the company. But the beneficial interest of a shareholder may be transferred by any agreement which is binding between the parties to the assignment. A trust is thus created, and the equitable rights of the beneficiary will be protected and enforced by a court of equity. The right of an assignee of shares to receive payment of dividends declared by the company is governed by the same principles as the rights of an assignee of any other liquidated claim.¹

§ 175. **Sales of Shares. — Rights and Liabilities as between Vendor and Purchaser.** — When shares are sold in the ordinary manner, the intention of the parties is that they shall be transferred in the condition in which they are at the time of the sale, and that the vendee shall be substituted in all respects in place of the vendor. The vendee becomes entitled, as against the vendor, to all subsequent dividends, and un-

¹ See *Fitchburg Savings Bank v. Torrey*, 134 Mass. 239; *Quiner v. Marblehead, &c. Ins. Co.*, 10 Mass. 476; *Sargent v. Franklin Ins. Co.*, 8 Pick. 90; *Planters', &c. Mutual Ins. Co. v. Selma Savings Bank*, 63 Ala. 585; *United States v. Cutts*, 1 Sumner, 133; *Ex parte Dobson*, 2 Mont., D. & D. 685; *Stebbins v. Phenix Fire Ins. Co.*, 3 Paige, 350; *Gilbert v. Manchester Iron, &c. Co.*, 11 Wend. 627; *Nesmith v. Washington Bank*, 6 Pick. 324; *Brigham v. Mead*, 10 Allen, 245; *Sabin v. Bank of Woodstock*, 21 Vt. 353; *Conant v. Reed*, 1 Ohio St. 298; *Baltimore, &c. Ry. Co. v. Sewell*, 35 Md. 252; *Duke v. Cahawba Nav. Co.*, 10 Ala. 82; *St. Louis, &c. Ins. Co. v. Goodfellow*, 9 Mo. 149; *Tuttle v. Walton*, 1 Ga. 43; *McCreedy v. Rumsey*, 6 Duer, 574. See *Johnson v. Lafin*, 5 Dill. 79, and cases cited.

dertakes to pay all subsequent calls. If the outstanding certificate of shares is delivered by the vendor to the vendee, it becomes the duty of the latter to surrender it, and cause a transfer to be executed on the books.

A vendor of shares may, by bill in equity, compel the purchaser to do all things necessary to be done on his part to obtain a complete transfer of the shares, and to indemnify the vendor on account of his liability to the corporation and its creditors.¹ The right of a vendor of shares to be indemnified by the purchaser on account of any liability to the corporation or to its creditors, may be enforced, either at law, by reason of the implied contract,² or in equity where the relation of trustee and *cestui que trust* exists between the parties.³

§ 176. **Liability for unpaid Calls.** — Shares are generally bought and sold, like tangible property, by delivery of the certificates issued by the corporation to the holder. These certificates indicate on their face to what extent the shares have been paid up.

If shares are sold by delivery of the certificates, it is reasonable to suppose that they are sold in the condition in which they appear to be at the time of the sale. If the certificates show that the shares have been paid up only partially, it is a fair implication that they are sold as partly paid up shares, and that the purchaser, and not the seller, is to be responsible for the amount remaining unpaid. It would seem to

¹ *Wynne v. Price*, 3 De G. & Sm. 310; *Cheale v. Kenward*, 3 De G. & J. 27; *Kellogg v. Stockwell*, 75 Ill. 68.

² *Walker v. Bartlett*, 18 C. B. 845, overruling *Humble v. Langston*, 7 M. & W. 517; *Chapman v. Shepherd*, L. R. 2 C. P. 228; *Grissell v. Bristowe*, L. R. 3 C. P. 112; *Bowring v. Shepherd*, L. R. 6 Q. B. 309; *Kellock v. Enthoven*, L. R. 9 Q. B. 241, affirming L. R. 8 Q. B. 458; *Davis v. Haycock*, L. R. 4 Exch. 373; *Brigham v. Mead*, 10 Allen, 245.

³ *Wynne v. Price*, 3 De G. & Sm. 310; *Kellogg v. Stockwell*, 75 Ill. 68; *Johnson v. Underhill*, 52 N. Y. 203; *Cheale v. Kenward*, 3 De G. & J. 27; *Morris v. Cannan*, 4 De G., F. & J. 581; *Hawkins v. Maltby*, L. R. 4 Ch. 200; *Evans v. Wood*, L. R. 5 Eq. 9; *Shaw v. Fisher*, 5 De G., M. & G. 596; 2 De G. & Sm. 11; *Cruse v. Paine*, L. R. 6 Eq. 641; 4 Ch. 441; *James v. May*, L. R. 6 H. L. 328; *Butler v. Cumpston*, L. R. 7 Eq. 16.

be immaterial in this respect whether a call was made before the sale or not. In the absence of an express agreement, the fair implication appears to be that the purchaser assumes the payment of whatever amount the certificates show to be due upon the shares. If the vendor should afterwards be compelled by the corporation to pay a call made before the sale,¹ he would have a claim for indemnity against the purchaser.

An agreement to sell and transfer shares, where there is no delivery of certificates and no reference to the amount paid upon the shares, would ordinarily be held to imply an agreement to sell and transfer fully paid up shares.²

These rules, however, are merely rules of construction. The rights and liabilities of a vendor or a purchaser of shares, as between each other, depend, in each case, upon the terms of their agreement.

§ 177. **Right to Dividends as between Assignor and Assignee.** — In determining the right to dividends as between the vendor and purchaser of shares, it is a well settled rule of construction that the vendor retains the right to all dividends declared before the sale, and the vendee is entitled to all declared thereafter, unless the contrary be expressly agreed upon by the parties. This is the rule, whether the dividend be payable before or after the sale, and whether the sale be private, or at the stock exchange, or in the open market.³

¹ See *supra*, § 161.

² Compare *Barnes v. Brown*, 80 N. Y. 527.

³ *Currie v. White*, 45 N. Y. 822; *Hyatt v. Allen*, 56 N. Y. 553; *Spear v. Hart*, 3 *Roberts*. (N. Y.) 420; *Lombardo v. Case*, 45 *Barb.* 95; *People v. Assessors*, 76 N. Y. 202; *Brundage v. Brundage*, 1 *T. & C.* (N. Y.) 82; *Hopper v. Sage*, 47 N. Y. *Super. Ct.* 77; *Bright v. Lord*, 51 *Ind.* 272; *Ohio v. Cleveland, &c.* R. R. Co., 6 *Ohio St.* 489; *Black v. Homersham*, L. R. 4 *Exch. Div.* 24; *Hague v. Dandeson*, 2 *Exch.*

741; *contra*, *Burroughs v. North Carolina R. R. Co.*, 67 N. C. 376.

In *Hill v. Newichawanick Co.*, 8 *Hun*, 459, 463, affirmed 71 N. Y. 593, the custom with respect to sales at the board of brokers in New York was stated as follows: "It is understood that sales of stock made at the board of brokers in this city at any time before the day fixed for the closing of the books of transfer of the corporation or company declaring a dividend payable at a future day, carry with them the dividend so declared, and the price

*Hill v. Newichawanick Co.*¹ is an illustration of one branch of this rule. The board of directors of the company in the month of January declared two dividends of four per cent each, the one payable immediately, and the other at a time to be fixed thereafter by the company's agent. The plaintiff was a shareholder in the company in January, and until the month of July, when his shares were sold at private sale to satisfy a debt for which they had been pledged. It was not until the month of November afterwards that the agent of the company declared the second instalment of four per cent to be payable. The court held that this belonged to the original owner of the shares, and not to the purchaser at the sale.

The other branch of the rule was applied in *Hyatt v. Allen*.² The plaintiffs had transferred certain shares to the defendant, under an agreement by which "all profits and dividends of and upon such stock" up to January 1, 1872, should be paid to the plaintiffs. No dividend was declared until April 9, 1872, but it was found that the greater part of the dividend declared on that day had been earned prior to the 1st of January. The court said: "The words 'profits and dividends,' in the contract in question, related to profits or dividends realized by the defendant as a stockholder, or declared by the company, prior to January 1, 1872, and, as no division of profits or declaration of dividends was made, the plaintiffs are not entitled to recover."

§ 178. **The Rule not affected by a Failure to transfer the Shares.** — The right to dividends upon shares, as between the vendor and vendee of the shares, does not depend upon the registration of the transfer, but solely upon the contract between the parties. The sale of a certificate for shares impliedly confers upon the purchaser the right to all dividends declared after the sale, although the purchaser would have no legal (as distinguished from equitable) claim to such

paid is regulated accordingly. After the books are closed, the sales are understood to be ex-dividend, and the price is correspondingly affected by the fact that the seller retains and is to collect the dividend."

¹ 8 Hun, 459, affirmed 71 N. Y. 593.

² 56 N. Y. 553.

dividends, as against the company, unless the transfer was registered as upon the books.¹

In *Currie v. White*,² it was held that a contract for the purchase and sale of shares at a specified price, "payable and deliverable, seller's option, in this year, with interest at the rate of six per cent per annum," must be treated as a sale *in presenti*, the vendor becoming a quasi trustee for the purchaser, and the latter is entitled to all dividends accruing on such shares thereafter. This construction evidently carries out the intention of the parties, whether the transaction was in reality a sale *in presenti* or not. But the seller under a contract of this description would be entitled to dividends *declared* before the contract was entered into, though not payable until after the shares were to be delivered.³

§ 179. **Rights of Tenant for Life of Shares.**—If the use of shares is transferred or bequeathed to one person for life, with remainder to another person, the tenant for life or for years is entitled to all dividends declared during the tenancy for life, in the absence of anything indicating a contrary intention, and the remainderman to all dividends declared thereafter, irrespective of the time during which they were earned.⁴ The presumption is that a legatee of shares is entitled to all dividends declared after the testator's death.⁵

§ 180. **Sales of Preferred Shares.**—The same rules apply to sales of preferred shares as to sales of common shares. *Boardman v. Lake Shore, &c. Ry. Co.*⁶ was a suit against a railway company to recover the amount of dividends payable from the year 1857 to 1863 upon certain preferred shares,

¹ *Manning v. Quicksilver Mining Co.*, 24 Hun, 360; *Jermain v. Lake Shore, &c. Ry. Co.*, 91 N. Y. 484.

² *Currie v. White*, 45 N. Y. 822.

³ *Spear v. Hart*, 3 Roberts. (N. Y.) 420.

⁴ See *Minot v. Paine*, 99 Mass. 101; *Chicago, &c. R. R. Co. v. Page*, 1 Biss. 461; *Harris v. San Francisco, &c. Co.*, 41 Cal. 393; and cases cited *infra*, §§ 445-447.

With regard to stock dividends, see *infra*, § 448.

⁵ *Jones v. Ogle*, L. R. 8 Ch. 192; *Ibbotson v. Elam*, L. R. 1 Eq. 188; *Browne v. Collins*, L. R. 12 Eq. 586; but see statute of 33 & 34 Vict. ch. 35.

⁶ *Boardman v. Lake Shore, &c. Ry. Co.*, 84 N. Y. 157, 178. See also *Manning v. Quicksilver Mining Co.*, 24 Hun, 360; *Jermain v. Lake Shore, &c. Ry. Co.*, 91 N. Y. 484.

which, according to the terms of the certificate, were entitled to annual dividends of ten per cent, payable out of net earnings, payment being guaranteed by the company. The plaintiff had purchased his shares in 1862, and no dividend was declared until 1863; but at the time when the suit was begun, the company had earned the whole amount of the unpaid instalments. The court held that the plaintiff was entitled to recover the entire sum. Miller, J., delivering the opinion, said: "Although usually there is no special contract of the company with the holders of stock to declare dividends, yet that does not alter or change the effect of the contract by which the plaintiffs hold their stock and become entitled to dividends thereon; for in both cases the dividends follow the stock itself, and belong to the owner. We think it cannot be maintained, upon any sound principle, that the contract for the payment of dividends continues to each stockholder only during the time he holds the stock and accrues only to his benefit during that period, and that a separate and distinct assignment of the dividends was essential in order to confer title upon the owner. Such a conclusion is adverse to the general rule which is upheld by authority, that a transfer of stock of a corporation carries with it to the transferee its proportionate share of the assets of the company, including dividends which have not been declared, and all the incidents and advantages which appertain to the rights of a shareholder."

§ 181. **What is Notice of the Rights of Equitable Owners.**—The rights of an equitable owner of shares will be protected by the courts against all persons except *bona fide* purchasers for value; and if the agents of the corporation should, with notice of the rights of the equitable owner, assist the legal holder to transfer the shares in violation of the trust, the company would be liable therefor.¹

¹ In *Parrott v. Byers*, 40 Cal. 614, 625, it was held that an assignee of shares whose title had not been perfected by a transfer on the books was entitled to the assistance of a

court of chancery, in order to protect his rights under the assignment from being impaired by the wrongful acts of the trustees.

In *Pennsylvania R. R. Co.'s Ap-*

The law upon this subject was stated clearly by Chief Justice Gray in *Loring v. Salisbury Mills Co.*¹ The learned judge said: "When the holder of a certificate of shares in a corporation is the absolute owner, his assignment and delivery thereof will pass the title to the assignee; and the latter, upon surrendering the former certificate, may obtain a new one in his own name. If the holder appears on the face of the old certificate to be the absolute owner, and the corporation has no notice that the fact is otherwise, it may safely issue a new certificate to the assignee, which, if taken in good faith and for a valuable consideration, will vest a perfect title in him.² But, for the protection of the rights of the lawful owner of the shares, the corporation is bound to use reasonable care in the issue of certificates; if, by the form of the certificate or otherwise, the corporation has notice that the present holder is not the absolute owner, but holds the shares by such a title that he may not have authority to transfer them, the corporation is not obliged, without evidence of such authority, to issue a certificate to his assignee; and if, without making any inquiry, it does issue a new certificate, and the rightful owner is injured by its negligent and wrongful act, the corporation is liable to him, without proof of fraud or collusion. All the authorities affirm such liability where the corporation has notice that the present holder is a trustee and of the name of his *cestui que trust*, and issues the new certificate without making any inquiry whether his trust authorizes him to make the transfer."³

peal, 86 Pa. St. 81, it was held that the circumstance that the signature of the assignor of a certificate of shares was thirteen years old was enough to arouse suspicion, and put the transfer agent on inquiry. *Lowry v. Commercial, &c. Bank*, Taney's Dec. 310. Compare *Friedlander v. Slaughter House Co.*, 31 La. Ann. 523.

¹ *Loring v. Salisbury Mills Co.*, 125 Mass. 150.

² Citing *Salisbury Mills Co. v. Townsend*, 109 Mass. 115; *Pratt v. Taunton Copper Manuf. Co.*, 123 Mass. 110.

³ Citing *Lowry v. Commercial, &c. Bank*, Taney's Dec. 310; *Bayard v. Farmers', &c. Bank*, 52 Pa. St. 232; *Atkinson v. Atkinson*, 8 Allen, 15; *Shaw v. Spencer*, 100 Mass. 382; *Fisher v. Brown*, 104 Mass. 259; *Duncan v. Jaudon*, 15 Wall. 165; *Shropshire Union Ry.*,

§ 182. **Transfer by Executors.**—The fact that shares are held or transferred by a person as executor is notice that there is a will open to inspection upon the public records; and the corporation and persons taking a transfer of the shares are bound, at their peril, to take notice of the contents of the will.¹

§ 183. **Effect of Notice that Shares are held in Trust.**—In *Shaw v. Spencer*,² the Supreme Court of Massachusetts held, in a carefully considered opinion, that the mere fact that a certificate of shares indicated upon its face that the holder was a trustee was sufficient to put the corporation and transferees of the shares upon inquiry, although neither the name of the *cestui que trust* nor the character of the trust was disclosed. It was decided that a person receiving such a certificate as a pledge to secure a debt of the holder could not hold the shares as against the *cestui que trust*, if the pledge was in violation of his rights.

A different conclusion was reached by the Supreme Court of California, in a case involving a similar state of facts; and the opinion, delivered by Crockett, J., shows a just appreciation of the principles which should govern the decision in this class of cases.³

§ 184. If a certificate for shares states on its face that the holder is a trustee, this would undoubtedly be notice to all persons receiving the certificate that the holder is not the absolute owner of the shares. Any person dealing with the trustee, in respect of the shares, would be bound to use reasonable care to ascertain the character of the trust, and to protect the rights of the beneficial owner.⁴

&c. Co. v. The Queen, L. R. 7 H. L. 496. See also *Magwood v. Railroad Bank*, 5 S. C. 379.

The corporation may use reasonable precautions to ascertain the authority of the trustee before permitting a transfer. *Bird v. Chicago, &c. R. R. Co.*, 137 Mass. 428. Compare *Iasigi v. Chicago, &c. R. R. Co.*, 129 Mass. 46; and see *infra*, § 211.

¹ *Stewart v. Firemen's Ins. Co.*,

53 Md. 564; *Lowry v. Commercial, &c. Bank*, Taney's Dec. 310; *Albert v. Savings Bank*, 2 Md. 159. Compare *Crocker v. Old Colony R. R. Co.*, 137 Mass. 417.

² *Shaw v. Spencer*, 100 Mass. 382.

³ *Brewster v. Sime*, 42 Cal. 139. See also *Albert v. Savings Bank*, 2 Md. 159; 1 Md. Ch. 407.

⁴ *Budd v. Munroe*, 18 Hun, 316; *Webb v. Graniteville Manuf. Co.*, 11 S. Car. 396.

But a person dealing with the trustee of an active trust is not, in all cases, under obligation to look after the interests of the *cestui que trust*. The rule in cases of this kind is the same as in cases of agency. If an agent or trustee is authorized by his principal, or *cestui que trust*, to perform certain acts, this is a representation that he will be liable, to all persons dealing with the agent or trustee in good faith, for such acts as are apparently within the scope of the agency or trust. Thus, if a trustee or agent is invested with a general authority to sell or pledge the property placed in his care, a purchaser in good faith, within the apparent scope of the trustee's or agent's powers, and in the usual course of business, would be safe, though the sale or pledge was in fact unauthorized and fraudulent. If a trustee or agent has authority to sell at all, the secret purpose of the sale would be wholly immaterial, and the purchaser would be under no obligation to see to the application of the purchase price.¹

These rules apply to transfers of shares held in trust.² If a trustee, or executor, or agent, has authority to sell or transfer shares under ordinary circumstances, any sale or transfer within the apparent scope of the authority conferred would bind the real owner.³

Whether a pledge of certificates for shares by a trustee can be received in safety depends upon circumstances. If the trustee has, by the terms of the trust, a general authority to pledge, a *bona fide* pledgee would be safe. If the terms of the trust are not disclosed, and the certificate merely shows that the holder is a trustee, a pledgee or purchaser in good faith would be protected only provided it could be shown to be a custom that trustees of shares have authority to sell or pledge the shares, where the terms of the trust are not indicated in the certificate.⁴

§ 185. **Assignment by Indorsement of Certificates.**—By general mercantile usage, shares in a corporation are assign-

¹ *Infra*, § 577 *et seq.*

³ *Lowry v. Commercial, & Co.*

² *Lowry v. Commercial, & Co. Bank*, Taney's Dec. 310.

Bank, Taney's Dec. 310; *Albert v.*

⁴ *Brewster v. Sime*, 42 Cal. 139.

Savings Bank, 2 Md. 159; 1 Md. Ch. 407.

able by indorsement, and delivery of the certificate issued to the owner as evidence of his rights. It is well settled that, after a certificate for shares has been indorsed by the holder, with an assignment and power of attorney to execute a transfer upon the stock-books, the name of the transferee and attorney being left blank, the certificate thus indorsed may be passed from hand to hand, and the last holder will be entitled to fill up the assignment and power of attorney, and complete the transfer by entry upon the books of the company.¹

In *Bank v. Lanier*,² Mr. Justice Davis said: "Stock certificates of all kinds have been constructed in a way to invite the confidence of business men, so that they have become the basis of commercial transactions in all the large cities of the country, and are sold in open market, the same as other securities. Although neither in form or character negotiable paper, they approximate to it as nearly as practicable. If we assume that the certificates in question are not different from those in general use by corporations, and the assumption is a safe one, it is easy to see why investments of this character are sought after and relied upon. No better form could be devised to assure the purchaser that he can buy with safety. He is told, under the seal of the corporation, that the shareholder is entitled to so much stock, which can be transferred on the books of the corporation in person or by attorney, when the certificates are surrendered, but not otherwise. This is a notification to all persons interested to know, that whoever in good faith buys the stock, and produces to the corporation the certificate, regularly

¹ *Kortright v. Buffalo, &c. Bank*, 20 Wend. 91; affirmed 22 Wend. 348; *Matthews v. Massachusetts Nat. Bank*, 1 Holmes, 396; *Broadway Bank v. McElrath*, 2 Beasley, 24; *Bridgeport Bank v. New York, &c. R. R. Co.*, 30 Conn. 231; *Winter v. Belmont Mining Co.*, 53 Cal. 428; *New York, &c. R. R. Co. v. Schuyler*, 34 N. Y. 30; *McNeil v. Tenth Nat. Bank*, 46 N. Y. 324; *Weaver v.*

Barden, 49 N. Y. 286; *Holbrook v. N. J. Zinc Co.*, 57 N. Y. 616; *Leitch v. Wells*, 48 N. Y. 586; *First Nat. Bank v. Gifford*, 47 Iowa, 575.

² *Bank v. Lanier*, 11 Wall. 377; *Johnston v. Laffin*, 103 U. S. 800.

A similar rule has been applied to other classes of certificates issued in the form of negotiable instruments. See *Chaffee v. Rutland R. R. Co.*, 55 Vt. 110.

assigned, with power to transfer, is entitled to have the stock transferred to him. And the notification goes further, for it assures the holder that the corporation will not transfer the stock to any one not in possession of the certificate."

§ 186. **The Liability of a Corporation to the Holder of a Certificate for Shares.**—It is clear, therefore, that the agents of a corporation should not issue certificates for a greater number of shares than the charter empowers them to create; for innocent purchasers, having no means of distinguishing the unauthorized from authorized shares, would be misled by the false representations contained in the certificates purporting to represent them. If the agents of a corporation, acting within the scope of their apparent powers, issue certificates for shares of stock in excess of the amount allowed by the company's charter, and an innocent purchaser is misled by the false certificates, the corporation will be liable to make compensation for any loss which he has suffered thereby.¹

It is the duty of a corporation which has issued a negotiable certificate for shares, and whose shares are transferable upon the books, not to permit a transfer to be executed upon the books, or to issue a new certificate, until the outstanding certificate has been surrendered. Both the corporation and the transferee would be chargeable with notice of the rights of the holder of the outstanding certificate, and if the latter was equitably entitled to the shares, he would have a right to set the transfer aside. If the corporation should recognize the transfer as valid, and refuse to accord to the holder of the certificate his legal rights, it would become liable to make good his damages; and if it should issue a new certificate to the transferee, it would become liable upon both the outstanding certificates to innocent purchasers for value.² It

¹ New York, &c. R. R. Co. v. &c. R. R. Co., 30 Conn. 231, Schuyler, 34 N. Y. 30; Holbrook v. 270; New York, &c. R. R. Co. New Jersey Zinc Co., 57 N. Y. v. Schuyler, 34 N. Y. 30; Lee v. 618; and see *infra*, § 586. Citizens' Nat. Bank, 2 Cin. 298;

² Bank v. Lanier, 11 Wall. 369; Smith v. American Coal Co., 7 Factors', &c. Ins. Co. v. Marine Dry Lansing, 317; Cleveland, &c. R. R. Docks, &c. Co., 31 La. Ann. 149; Co. v. Tappett, 22 A. L. J. 117; Bridgeport Bank v. New York, Strange v. H. & T. C. R. R. Co.,

is not necessary that the certificate should state upon its face that the stock is transferable on the books "upon surrender of this certificate." For it is implied that the certificate must be surrendered before a transfer can be made.¹

§ 187. **Liability of Agents issuing void Certificates.** — Upon a similar principle, it follows that, if the agents of a corporation fraudulently issue stock certificates which are void for any reason to an innocent purchaser for value, the latter is entitled to hold such agents personally liable for any damages which he suffers through their fraud. As certificates issued in the usual form are intended to pass from hand to hand like negotiable instruments, it is evident that the implied representation that they are valid extends to every purchaser from the first holder; and if this representation is false and fraudulent, any purchaser who is deceived has a cause of action for his damages.²

§ 188. **Lost or destroyed Certificates.** — A by-law requiring the outstanding certificates to be surrendered or proven to be lost before the issue of new ones in their place, is clearly binding upon all the stockholders, their representatives and assignees.³ Where a certificate has been lost, and a bill is brought to obtain a new certificate and a transfer on the books, the decree must provide ample security to the corporation against loss in case the certificates should afterwards come into the hands of a *bona fide* purchaser.⁴ If a new certificate should be issued by a corporation, in pursuance of a provision in its charter, in place of a certificate supposed to be lost, the corporation would nevertheless remain liable to a *bona fide* holder of the first certificate.⁵

§ 189. **Purchasers of Certificates.** — It has been pointed out, that, if the charter of a corporation requires a transfer of shares to be executed upon the books, the mere assignment of a certificate for shares cannot constitute the assignee a

53 Tex. 162. Compare National Bank v. Lake Shore, &c. Ry. Co., 21 Ohio St. 221.

³ State v. New Orleans, &c. R. R. Co., 30 La. Ann. 308.

⁴ Galveston City Co. v. Sibley, 56 Texas, 269.

¹ Factors', &c. Ins. Co. v. Marine Dry Dock, &c. Co., 31 La. Ann. 149.

⁵ Cleveland, &c. R. R. Co. v. Robbins, 35 Ohio St. 483.

² See cases *infra*, § 554.

shareholder as against the corporation. An assignment, in such case, does not operate as a novation of the contract of membership. The assignor is not discharged from his contract, nor does the assignee become subject to any liability to the corporation or its creditors, until a complete transfer or novation has been effected. An assignee of shares can claim no interest in the corporation except through the assignor; and hence he is not entitled to vote or enjoy any other privileges which belong only to regular members of the company.

But while a transfer of shares by assignment of the certificate can be effective only between the parties to the assignment, yet it has been held, in accordance with the usages of trade, that the indorsement of the certificate invests the assignee with the legal title to the interest so assigned, as against all persons except the corporation. Certificates for shares are dealt with in the market like negotiable paper or chattels. The certificates are considered as representing the shares themselves, and, when properly indorsed, are passed from hand to hand like tangible property. The ownership of a certificate for shares therefore confers an apparent right to the ownership of the shares which they represent, and of a power to complete the title as against the company by executing a transfer upon the books.

§ 190. **Rights of bona fide Purchasers.** — Accordingly it was held, in *McNeil v. Tenth National Bank*,¹ that where the owner of certain shares of stock had pledged his certificate, indorsed with an assignment and power of attorney in blank, and the pledgee wrongfully assigned the certificate to a *bona fide* purchaser without notice, the title of such purchaser was superior to that of the prior owner. Rapallo, J., said: "The holder of such a certificate and power possesses all the external *indicia* of title to the stock, and an apparently unlimited power of disposition over it. He does not appear to have, as is said in some of the authorities cited concerning the assignee of a chose in action, a mere equitable interest, which is said to be notice to all persons dealing with him that they

¹ *McNeil v. Tenth Nat. Bank*, 46 N. Y. 325.

take subject to all equities, latent or otherwise, of third parties ; but, apparently, the legal title and the means of transferring such title in the most effectual manner.”¹

Upon the same principle, it has been held that the doctrine of constructive notice by *lis pendens* has no application to certificates for shares which pass from hand to hand by delivery and indorsement of the certificate, like negotiable instruments.²

It has likewise been held, that, if certificates for shares which have been indorsed in blank are wrongfully taken from the possession of the rightful owner, and afterwards come into the hands of a *bona fide* purchaser, the latter will obtain a valid title to the shares.³ This doctrine is based upon the same reasons as the similar doctrine applicable to negotiable bills and notes indorsed or signed in blank. Instruments of this description are intended to pass from hand to hand, and purchasers have no means of ascertaining the rights of the holder ; they look merely to the genuineness of the signatures. It is this circumstance that gives such instruments their character and value. In view of the custom by which certificates indorsed in blank are transferable from hand to hand, like negotiable paper, the owners of such certificates should be required to use the utmost care and diligence in

¹ McNeil v. Tenth Nat. Bank, 46 N. Y. 325, 332; Moore v. Metropolitan Nat. Bank, 55 N. Y. 41; Dickinson v. Dudley, 17 Hun, 569; Garvin v. Wiswell, 83 Ill. 215; Otis v. Gardner, 105 Ill. 436; Lowry v. Commercial, &c. Bank, Taney's Dec. 310, 327, 328; Holbrook v. New Jersey Zinc Co., 57 N. Y. 616; Cherry v. Frost, 7 Lea, 1; Moodie v. Seventh Nat. Bank, 11 Phila. 366; Burton v. Peterson, 12 Phila. 397; Burton's Appeal, 93 Pa. St. 214; West Branch, &c. Canal Co.'s Appeal, 81* Pa. St. 19; Baldwin v. Canfield, 26 Minn. 43; Strange v. H. & T. C. R. R. Co., 53 Tex. 162; Baker v. Wasson, Id. 150, Goodwin v. Robarts, L. R. 1 App. Cas. 476;

Rumball v. Metropolitan Bank, L. R. 2 Q. B. Div. 194. Compare Crocker v. Crocker, 31 N. Y. 507; Weaver v. Barden, 49 N. Y. 286; and see Shropshire Union Ry., &c. Co. v. Regina, L. R. 7 H. L. 496, and L. R. 8 Q. B. 420.

² Leitch v. Wells, 48 N. Y. 586; Holbrook v. New Jersey Zinc Co., 57 N. Y. 616.

³ Winter v. Belmont Mining Co., 53 Cal. 428, explaining Sherwood v. Meadow Valley Mining Co., 50 Cal. 412. But see Barstow v. Savage Mining Co., 64 Cal. 388; Sprague v. Coheco Manuf. Co., 10 Blatchf. 173; Pennsylvania R. R. Co.'s Appeal, 86 Pa. St. 80.

their safe keeping; if a *bona fide* purchaser should be deceived through any negligence or want of diligence in this respect, justice requires that the owner should suffer the loss.¹ Thus, if the holder of certificates indorsed in blank should intrust them to an agent or servant, who proves faithless and fraudulently sells them, the owner who selected the custodian of the certificates should be made to suffer, and not an innocent purchaser.²

§ 191. **Indorsement of Certificate held to be a Warranty of Genuineness.** — It has been held, that the execution of an assignment in blank and power of transfer upon the back of a certificate for shares is a warranty of its genuineness, and that this warranty may be enforced by any *bona fide* purchaser of the certificate who fills up the assignment with his name. A purchaser of a forged certificate indorsed with an assignment in blank may therefore hold the person who made the indorsement liable to make good the loss.³

It has been held, however, that, while the vendor of a certificate for shares impliedly warrants the genuineness of the certificate sold, or, in other words, that the certificate was in fact issued by the officers of the corporation, he does not impliedly warrant that the certificate represents valid shares. If the certificate was issued to represent shares which the corporation had no power to create, the purchaser would according to this rule have a remedy against the corporation, but not against the vendor of the certificate on an implied warranty.⁴

It is clear, however, that a *contract* to sell and deliver shares, or a certificate for shares, in a corporation, is not ful-

¹ Upon this question see *Davis v. Bank of England*, 2 Bing. 393; *Ex parte Swan*, 7 C. B. N. s. 400; *Swan v. North British Australasian Co.*, 7 H. & N. 603; 2 H. & C. 175; *Taylor v. Great Indian, &c. Ry. Co.*, 4 De G. & J. 559; *Johnston v. Renton*, L. R. 9 Eq. 181; *Taylor v. Midland Ry. Co.*, 28 Beav. 287; 8 H. L. C. 751; *Biddle v. Bayard*, 13 Pa. St. 150; *Mundorff*

v. Wickersham, 63 Pa. St. 87. The question of negligence is for the jury, under the necessary explanations and instructions of the court. *Aull v. Colket*, 33 Leg. Int. 44.

² See cases in the preceding notes.

³ *Matthews v. Massachusetts Nat. Bank*, 1 Holmes, 396.

⁴ *People's Bank v. Kurtz*, 99 Pa. St. 344.

filled by the delivery of a certificate representing, not shares, but a claim for false representations.¹

§ 192. **Whether Power of Attorney is necessary.** — The execution of a power of attorney to complete a transfer upon the books is probably not essential where there is an absolute sale of the shares. The sale itself implies a delegation of authority to the vendee, or person entitled to the shares, to make the necessary transfer.²

Certificates indorsed in blank are intended to pass from hand to hand, like negotiable paper, and there is generally no real privity between the original holder of the certificate and the last owner, who registers the transfer. Although the transfer upon the books must be made by some one who, in the eye of the law, acts as agent of the transferor, this agency is usually a fiction. The entry of the transfer is a mere form, and the transferor has usually no privity whatever with the person who actually makes the entry. Under these circumstances, the transferor ought not to suffer by reason of any fraud of the party executing the transfer, or to be charged with his guilty knowledge.³ It has also been held, very justly, that a blank assignment and power of attorney to transfer shares of stock may be filled up after the death of the transferor, and the stock transferred under it.⁴

§ 193. **Rights of an Assignee of a Certificate against Creditors of the Assignor.** — The authorities relating to the validity of an assignment of shares by delivery of the certificate, as against creditors of the person in whose name the shares appear on the company's books, are conflicting, but the principles which should govern cases of this description are very simple.

It is certain that shares in a corporation are not in reality tangible property;⁵ they are contract rights, or "choses in action" according to legal terminology. Shares are usually represented by certificates. Although these certificates are,

¹ See *Barnes v. Brown*, 80 N. Y. 527.

² *Supra*, §§ 175-177.

³ *Johnson v. Laffin*, 5 Dill. 65; 103 U. S. 800.

⁴ *Fraser v. Charleston*, 11 S. Car. 486.

⁵ This refers to shares in a continuing company, not shares in the assets after dissolution.

in their origin, merely evidences of the holder's rights, they are really something more. They are treated in many respects as if they were the shares themselves, and when passed from hand to hand are considered as passing to the assignee all the equitable rights of the holder, and a legal right against the corporation to be admitted as a shareholder on the books. The certificates thus have a value in themselves, and may rightly be treated as property. They are similar in this respect to negotiable paper. The debt of the maker of a negotiable note is a mere contract right, or chose in action, belonging to the payee, but the note itself may properly be treated as a chattel or thing in the hands of the holder. So shares in a corporation are mere contract rights, or choses in action, while the certificates are treated as the embodiment of these rights, and may be considered as chattels. The assignment of a certificate for shares ought, therefore, to have the same effect as to the creditors of the assignor as the indorsement and delivery of a bill or note.

§ 194. The assignment of an ordinary debt or chose in action confers upon the assignee all the equitable rights of the assignor. The general rule is, that the rights of an equitable assignee will be protected as against all persons except those who have prior equities, or who have equal equities in addition to the legal title. Thus, an assignee in bankruptcy, or under a voluntary assignment for the benefit of creditors, acquires no greater estate than belonged to the bankrupt at the time of the filing of the petition or execution of the deed; he therefore takes all legal claims and titles vested in the bankrupt, subject to the rights of equitable assignees.

This rule applies to shares in corporations, as well as other species of property. If a bankrupt has transferred the equitable ownership of shares before the filing of the petition or execution of the deed, the rights of the equitable assignee will be protected, although the bankrupt remained the legal owner of the shares upon the books of the company.¹

¹ *Dickinson v. Central Nat. Bank*, 129 Mass. 279; *Sibley v. Quinsigamond Nat. Bank*, 133 Mass. 515.
Blouin v. Liquidators of Hart, 30 La. Ann. 714;

§ 195. It should be observed, however, that the case of a purchaser of a certificate for shares issued by a corporation in the usual form is much stronger than the case of an assignee of an ordinary chose in action. The purchaser of a certificate for shares acquires, not merely an equitable claim against the company, as assignee of the rights of the original holder, but also a legal right, under the agreement set out in the certificate, to become a shareholder on the company's books upon surrendering the certificate for cancellation.¹

Certificates for shares are known to be transferable like negotiable paper, and there can be but one certificate outstanding representing the same shares. The possessor of a certificate for shares, properly indorsed, has an almost absolute control over the shares. He can confer a valid title, although having no title in himself, by selling the certificates to a *bona fide* purchaser for value.²

It is clear, therefore, that the possession of certificates for shares carries with it the *indicia* of ownership to a greater extent even than the possession of ordinary tangible property.³

§ 196. **Rights of Attaching Creditors of the Shareholder on the Books against a prior equitable Assignee.** — A creditor does not, by levying an attachment or execution upon property, occupy the position of a *bona fide* purchaser for value. A creditor is entitled only to step into the place of the debtor in respect to the latter's property and contract rights. He is not entitled, upon any principle of justice or common honesty, to pay his debt out of property which does not in truth belong to the debtor. A creditor, therefore, ought not to be allowed to levy upon shares after the real, substantial, and equitable ownership has been transferred to a purchaser for value. It is wholly immaterial, for this purpose, whether the shares have been transferred on the company's books or not. A transfer on the books is required merely to perfect the strictly legal title as against the corporation; the equitable rights of the shareholder pass by a simple assignment. After the assignment the debtor would retain at most a

¹ *Infra*, § 216.

² *Supra*, § 189.

³ See *Walker v. Detroit, &c. Ry. Co.*, 47 Mich. 338.

naked legal claim as against the corporation, and this is all that the creditor would be entitled to take.

But even the strictly legal title of the shareholder would cease to be transferable after an assignment of the certificate. By the terms of the certificate, the corporation certifies that the holder is entitled to a specified number of shares, and that these shares are transferable upon a surrender of the certificate by the holder or his assignee. By the contract of the parties, the corporation is liable to the assignee of the certificates to receive him as shareholder upon a compliance with the forms of a transfer, and it is not liable to receive any assignee until the certificate is surrendered. To hold that a creditor of a person appearing as shareholder upon the company's books can obtain a valid title to the shares by levying an attachment or judgment, after the holder has assigned the certificates to a purchaser for value, would therefore not only be in violation of the rights of the equitable owner of the shares, but would be in violation of the contract entered into by the corporation.¹

Statutes authorizing shares in a corporation to be attached usually provide that the attachment may be levied by serving a notice or copy of the writ upon the corporation. Under such a statute, the lien of an attaching creditor of the holder of shares on the books of the company would not be divested by a subsequent sale of the outstanding certificates, although the purchaser should be an innocent purchaser without notice.²

¹ *Broadway Bank v. McElrath*, 2 Beasley (13 N. J. Eq.), 24; *Hunterdon County Bank v. Nassau Bank*, 17 N. J. Eq. 496; *Beckwith v. Burrough*, 13 R. I. 294; *Black v. Zacharie*, 3 How. 483; *Smith v. Crescent City Live Stock, &c. Co.*, 30 La. Ann. 1378; *Fraser v. Charleston*, 11 S. Car. 486, 519; *Farmers', &c. Bank v. Wasson*, 48 Iowa, 336; *Cornick v. Richards*, 3 Lea (Tenn.), 1; *Merchants' Nat. Bank v. Richards*, 74 Mo. 77; *De Comeau v. Guild Farm*

Oil Co., 3 Daly, 218; *Robinson v. National Bank*, 95 N. Y. 637; *Scott v. Pequonnock Nat. Bank*, 15 Fed. Rep. 494.

If, however, certificates for shares are merely pledged as security for a debt, an attaching creditor of the pledgor would be entitled to claim any surplus remaining after satisfaction of the debt. *Seeligson v. Brown*, 61 Tex. 114.

² *Shenandoah Valley R. R. Co. v. Griffith*, 76 Va. 913.

§ 197. **Conflicting Authorities.**—In Massachusetts, it is held that shares in a corporation whose charter provides that they shall “be transferable only on its books,” cannot be effectually assigned by delivery of the certificates indorsed with an assignment and blank power of attorney to transfer, as against a creditor of the vendor who attaches without notice of the sale, even if notice of the assignment be given to the corporation before the attachment.¹ But it is also held in the same State, that where the provision requiring a transfer to be executed on the books is not contained in the charter or an enactment of the legislature, but merely in the by-laws adopted by the company, the purchaser would obtain a valid title as against the attaching creditor.²

This distinction, in the writer’s opinion, is an arbitrary one. Provisions requiring transfers of shares to be executed on the stock-books are evidently intended to accomplish precisely the same purposes, whether such provisions be contained in charters, or general incorporation laws, or by-laws adopted by the incorporators after organization. In each case the object is to regulate and determine the rights and liabilities of the shareholders as between each other,—to provide the

¹ *Fisher v. Essex Bank*, 5 Gray, 373; *Blanchard v. Dedham, &c. Co.*, 12 Gray, 213; *Rock v. Nichols*, 3 Allen, 342; *Dickinson v. Central Nat. Bank*, 129 Mass. 281; *Central Nat. Bank v. Williston*, 138 Mass. 244. See also *Application of Murphy*, 51 Wis. 519; *Skowhegan Bank v. Cutler*, 49 Me. 315; *People’s Bank v. Gridley*, 91 Ill. 457; *Shipman v. Ætna Ins. Co.*, 29 Conn. 245.

The rule as to national banks is otherwise. *Sibley v. Quinsigamond Nat. Bank*, 133 Mass. 515; *Scott v. Pequonnock Nat. Bank*, 15 Fed. Rep. 494.

² *Sargent v. Essex Marine Ry. Co.*, 9 Pick. 202; *Boston Music Hall Ass. v. Cory*, 129 Mass. 435. As to the rule in Connecticut, see *Scott v.*

Pequonnock Nat. Bank, 15 Fed. Rep. 494.

In 1881 the rule laid down by the courts in Massachusetts appears to have been reaffirmed by legislative enactment. See *Laws of 1881*, chap. 302; *Public Sts. c. 105*, § 24. But in 1884 it was enacted that “the delivery of a stock certificate of a corporation to a *bona fide* purchaser or pledgee, for value, together with a written transfer of the same, or a written power of attorney to sell, assign, and transfer the same, signed by the owner of the certificate, shall be sufficient delivery to transfer the title as against all parties.” *Laws of 1884*, chap. 229. As to these acts, see *Newell v. Williston*, 138 Mass. 240.

company with the means of ascertaining who are liable for calls, who are entitled to vote, and to whom dividends may be paid.

Perhaps a provision of this description, when contained in the charter, is also intended in part to provide creditors of the corporation with a record of those whom they may charge with individual liability in case of the insolvency of the company. But it would be absurd to claim that the object of such an enactment is to provide the public with a registry of the owners of shares. The public have no right whatever to examine the books of a corporation in order to ascertain who are its shareholders; and even if such a right were conferred by statute, it is not likely that creditors would examine the stock-books of the various corporations throughout the country in order to find shares registered in the names of their debtors.

Nor can it reasonably be contended that the object of a provision of this character is to abolish altogether ordinary assignments by indorsement of the certificates. The practice of buying and selling shares by assignment of the certificates is so firmly established by the universal custom of business men, and is so useful and convenient in itself, that it would take a very clear expression of the legislative will to abolish it. Moreover, this custom has been recognized and approved by legislative enactments in almost every State in the Union.

There is no inconsistency between a law requiring *transfers* to be executed on the stock-books, and a custom by which *assignments* of shares are made by indorsement and delivery of the certificates. A transfer of shares means a complete substitution of shareholders, and novation of the contract of membership, as against the corporation, as well as the parties to the transfer; an assignment means a transfer of the equitable ownership, together with a right to obtain a complete transfer upon complying with the forms prescribed by the charter. To hold that a provision requiring all transfers to be executed on the books implies a prohibition against assignments by delivery of the certificates, is to place a strained

and unnecessary construction upon the statute in order to reach a very undesirable result.¹

§ 198. **Rights of Assignee against Creditors of the Assignor further considered.** — It has sometimes been argued, that, inasmuch as the legal title to shares can be transferred only on the books, in the manner prescribed by the charter, an assignment without the proper entry on the books is evidence of a secret trust, and, if unexplained, is to be deemed fraudulent and void as against creditors of the assignor, like an assignment of personal property without delivery of possession.² This argument shows a singular ignorance of the true state of affairs. It has already been pointed out that possession of the certificates confers the apparent ownership of shares, and that the stock-books of a corporation are not a record provided for the public. In a centre of business activity like New York, the fact that a person's name appears on the stock-books of a corporation whose shares are in the market, would hardly raise a presumption that he is the real owner.

§ 199. In other cases it has been held that a *bona fide* purchaser of certificates of shares obtains a valid title to the shares as against an attaching creditor, who has notice of the assignment, but not as against a creditor who attaches without notice.³ It is not apparent upon what principle this distinction is made. An attaching creditor is not a pur-

¹ See the lucid opinion of Chancellor Green in *Broadway Bank v. McElrath*, 2 Beasley (13 N. J. Eq.), 24; *Black v. Zacharie*, 3 How. 483, 513; *Baldwin v. Canfield*, 26 Minn. 43.

² See *Pinkerton v. Manchester, &c. R. R. Co.*, 42 N. H. 424. Compare *Scripture v. Frankestown Soapstone Co.*, 50 N. H. 571.

³ *Cheever v. Meyer*, 52 Vt. 66. See *Sabin v. Bank of Woodstock*, 21 Vt. 353; *Scripture v. Frances-town Soapstone Co.*, 50 N. H. 571; *Weston v. Bear River, &c. Mining*

Co., 6 Cal. 425; *Fisher v. Essex Bank*, 5 Gray, 373.

It has been held that the purchaser of a certificate must give notice of his rights to the corporation, in order to protect himself from attaching creditors of the vendor. *Williams v. Mechanics' Bank*, 5 Blatchf. 59; *State Insurance Co. v. Sax*, 2 Tenn. Ch. 507. See also *First Nat. Bank of Hartford v. Hartford, &c. Ins. Co.*, 45 Conn. 22; *Colt v. Ives*, 31 Conn. 25. Compare also *Friedlander v. Slaughterhouse Co.*, 31 La. Ann. 523.

chaser for value. He has no equitable right to be paid out of property of which the debtor is not the beneficial owner. If, however, the right of an attachment creditor to take shares appearing in the debtor's name upon the company's books is derived from the arbitrary enactment of the legislature, whether in the attachment laws or the charter of the company, upon what principle can the courts deprive a creditor of this right merely because he had notice of an assignment, if no such exception is made by the statute?

§ 200. In some instances, it has been held that a purchaser at an execution sale of shares appearing in the name of the execution debtor on the books of the company obtains a valid title against an assignee of the certificates, unless the purchaser has notice of the assignment.¹ This view proceeds upon a supposed analogy between a purchase of chattels taken on execution against the holder of the legal title, and a purchase of shares of which the debtor appears to be the holder on the company's books. There is, however, an important difference between the two cases. Shares are not in fact chattels, while the certificates are; the shares are merely contract rights. These rights are, by agreement between the corporation and the shareholder, made assignable by delivery of the certificates. After such assignment, the holder on the books ceases to have the equitable ownership, and does not, properly speaking, retain the legal title either. By the terms of the certificate the purchaser is entitled to be admitted as shareholder by simply going through the form of a transfer.

A purchaser at an execution sale of shares, where the outstanding certificates have not been taken, must know that the holder of the certificates is, by agreement of the parties, the real owner of the shares. He cannot be a *bona fide*

¹ Farmers' National Gold Bank v. Wilson, 58 Cal. 600; Naglee v. Pacific Wharf Co., 20 Cal. 529; Weston v. Bear River, &c. Mining Co., 5 Cal. 186. not obtain priority over the assignee of the certificates. Newberry v. Detroit, &c. Iron Co., 17 Mich. 141; Weston v. Bear River, &c. Mining Co., 6 Cal. 425.

A purchaser with notice would

purchaser without notice. The case would be similar to a sale under statutory process of the debt represented by a promissory note, under an execution against the payee, after the note itself had been negotiated by the payee. It could not be contended that the purchaser at the execution sale would obtain title against the indorsee, even though not notified of the latter's rights.

§ 201. **When a Corporation has a Lien upon the Shares of its Members.**—By the common law, a corporation has no lien upon the shares of its members for calls, or for other debts which they owe to the company, unless a lien has been created by agreement of the parties; and, in the absence of an express provision limiting the right of transfer, a corporation cannot refuse to permit a transfer of shares to be executed upon the stock-books, merely because the existing holder is indebted to the company.¹ But a lien may be reserved by a special agreement with the shareholder,² and this agreement may be shown by evidence of a general usage or course of business on the part of the company.³

It seems that the majority in a shareholders' meeting have implied authority to enact a by-law giving the company a lien upon the shares of its members, and to prohibit a transfer of shares from being executed upon the books while the holder is indebted to the corporation.⁴ A by-law of this

¹ *Williams v. Lowe*, 4 Neb. 398; *County Bank*, 26 Conn. 144; *People Case v. Bank*, 100 U. S. 446; *Merchants' Bank v. Shouse*, 102 Pa. St. 488; *Steamship Dock Co. v. Heron*, 52 Pa. St. 280; *Driscoll v. West Bradley, &c. Manuf. Co.*, 59 N. Y. 102; *Bank of Holly Springs v. Pinson*, 58 Miss. 421, 435; *Farmers', &c. Bank v. Wasson*, 48 Iowa, 340; *Carroll v. Mullanphy Savings Bank*, 8 Mo. App. 249, 252; *Sargent v. Franklin Ins. Co.*, 8 Pick. 90; *Massachusetts Iron Co. v. Hooper*, 7 Cush. 183; *Heart v. State Bank*, 2 Dev. Eq. 111; *Neale v. Janney*, 2 Cranch, C. C. 188; *Bryon v. Carter*, 22 La. Ann. 98; *Vansands v. Middlesex*

County Bank, 26 Conn. 144; *People v. Crockett*, 9 Cal. 112.

But dividends declared by the company may be retained as a set-off. *Sargent v. Franklin Ins. Co.*, 8 Pick. 90; *Hagar v. Union Nat. Bank*, 63 Me. 509; *Bates v. N. Y. Ins. Co.*, 3 Johns. Cas. 238.

² *Vansands v. Middlesex County Bank*, 26 Conn. 144.

³ *Morgan v. Bank of North America*, 8 S. & R. 73.

⁴ *In re Bachman*, 12 Nat. B. Reg. 223; *Tuttle v. Walton*, 1 Ga. 43; *McDowell v. Bank of Wilmington*, 1 Harringt. 27; *Lockwood v. Mechanics' Nat. Bank*, 9 R. I. 308;

description would undoubtedly be valid under a charter expressly providing that the shares of the shareholders shall be transferable upon the books of the company, according to such rules and subject to such limitations as the shareholders may from time to time establish.¹ But the by-law must be adopted by vote of the majority, and not merely by the board of directors.²

§ 202. Where it is provided by the charter of a corporation, or a by-law enacted under it, that debts or calls due to the company by a shareholder shall be discharged before he shall be entitled to transfer his shares, an assignee of the shares cannot compel the company to receive him as a member, or to enter a transfer upon the books, until the lien of the company has been discharged.³ Under a provision requiring all calls made upon shares to be paid before any transfer shall be deemed valid, a call will be considered as

Cunningham v. Alabama L. Ins., & Co., 4 Ala. 652; Geyer v. Western Ins. Co., 3 Pittsb. 41; Morgan v. Bank of North America, 8 S. & R. 73; Child v. Hudson's Bay Co., 2 P. Wms. 207; Brent v. Bank of Washington, 10 Pet. 616. Compare Bryon v. Carter, 22 La. Ann. 98; and see *contra*, Driscoll v. West Bradley, & Co. Manuf. Co., 59 N. Y. 102, 106; Carroll v. Mullanphy Savings Bank, 8 Mo. App. 249, 252; *semble*, Steamship Dock Co. v. Heron, 52 Pa. St. 280; Nesmith v. Washington Bank, 6 Pick. 324.

A national bank is prohibited by the provisions of the National Banking Acts from reserving a lien on the shares of its shareholders. Delaware, & Co. R. R. Co. v. Oxford Iron Co., 38 N. J. Eq. 340 and notes; Bank v. Lanier, 11 Wall. 369; Bulard v. Bank, 18 Wall. 589; Evansville Nat. Bank v. Metropolitan Nat. Bank, 2 Biss. 527; Hagar v. Union Nat. Bank, 63 Me. 509; Rosenback v. Salt Springs Nat. Bank, 53 Barb.

495; Conklin v. Second Nat. Bank, 45 N. Y. 655; Lee v. Citizens' Nat. Bank, 2 Cin. 298, 306. See *infra*, § 384.

¹ Pendergast v. Bank of Stockton, 2 Sawy. 108; Geyer v. Western Ins. Co., 3 Pittsb. 41; Brent v. Bank of Washington, 10 Pet. 616; St. Louis, & Co. Ins. Co. v. Goodfellow, 9 Mo. 149; Mechanics' Bank v. Merchants' Bank, 45 Mo. 513; Cunningham v. Alabama L. Ins., & Co., 4 Ala. 652; Bank of Holly Springs v. Pinson, 58 Miss. 421, 435.

² Carroll v. Mullanphy Savings Bank, 8 Mo. App. 249, 252; Bank of Attica v. Manufacturers', & Co. Bank, 20 N. Y. 501.

³ Brent v. Bank of Washington, 10 Pet. 596; Farmers' Bank v. Iglehart, 6 Gill, 50; Reese v. Bank of Commerce, 14 Md. 271; Sabin v. Bank of Woodstock, 21 Vt. 353; Tuttle v. Walton, 1 Ga. 43; McCready v. Rumsey, 6 Duer, 574; Rogers v. Huntingdon Bank, 12 S. & R. 77.

having been made from the time that the resolution of the directors making the call has been notified to the shareholders; and the company cannot be required to accept a transfer until every such call has been paid.¹

§ 203. **Rights of Purchasers of Shares where Lien is reserved.** — If the lien is provided by the company's charter or articles of association, or by a general law, all persons purchasing shares are bound thereby, and must at their peril inquire of the company's officers whether the holder of the shares is indebted to it or not. But if the lien is conferred through a by-law, a purchaser without notice of the by-law is not bound. It is therefore advisable, in this case, to refer to the by-law in the certificates issued by the company, so as to notify all purchasers of shares.²

§ 204. **Character of the Lien. — Its Application.** — The character and extent of the lien of a corporation upon the shares of its members necessarily depends in each case upon the terms of the provision in the charter or by-laws conferring it.³

It has been held that a note not due is a "debt," within the meaning of a provision in the charter of a corporation creating a lien upon the shares of a shareholder, and restricting the right of transfer until all debts due the company by such shareholder have been paid.⁴ And the word "indebted"

¹ *Shaw v. Rowley*, 5 Eng. Ry. Cas. 47; *Ex parte Tooke*, 6 Eng. Ry. Cas. 1. Compare *Newry, & Co. v. Edmunds*, 5 Eng. Ry. Cas. 275; s. c. 2 Exch. 118; *Ambergate, & Ry. Co. v. Mitchell*, 6 Eng. Ry. Cas. 235; s. c. 4 Exch. 540; *Great North of England Ry. Co. v. Bid-dulph*, 7 M. & W. 243; *Regina v. Wing*, 33 Eng. L. & Eq. 80.

² *Driscoll v. West Bradley, etc.*, Manuf. Co., 59 N. Y. 109; *Bank of Holly Springs v. Pinson*, 58 Miss. 421; *Planters', & Co. Mutual Ins. Co. v. Selma Savings Bank*, 63 Ala. 585; *Mount Holly Paper Co.'s Appeal*, 99 Pa. St. 513; *Anglo-Californian Bank v. Grangers' Bank*, 63 Cal. 359.

The same rule applies whether the corporation is a domestic or foreign corporation. A purchaser of shares in a foreign corporation must take notice of its charter. *Bishop v. Globe Co.*, 135 Mass. 132; *infra*, § 571.

³ *Petersburg Savings, & Co. v. Lumsden*, 75 Va. 327; *Shenandoah Valley R. R. Co. v. Griffith*, 76 Va. 913.

⁴ *Grant v. Mechanics' Bank*, 15 S. & R. 140; *Sewall v. Lancaster Bank*, 17 S. & R. 285; *Pittsburgh, & Co. R. R. Co. v. Clarke*, 29 Pa. St. 146; *Cunningham v. Alabama L. Ins., & Co.*, 4 Ala. 652; *McCready v. Rumsey*, 6 Duer, 574.

has been held to include even the collateral liability of a surety. Thus, in *St. Louis Perpetual Insurance Co. v. Goodfellow*,¹ Scott, J., said: "The word *indebted*, when employed in a by-law or charter, restraining a stockholder from transferring his stock while indebted to the company, applies as well to debts to become due as to those which are actually due, and as well to those owing by the stockholder as surety or indorser as to those in which he is the principal debtor. The time of negotiating a loan is the period the directors must look out for security; the fact that a borrower or his indorser is a stockholder may induce them to be less attentive in taking security than they would otherwise be."

But it is clear that a provision that no transfer of shares shall be allowed so long as the holder is in arrears to the company, "or in any form indebted to it," would not prevent a shareholder from transferring his shares merely because they have not been fully paid up, if all calls that have been made upon the shares are paid.²

The lien of a company, under a provision that "no shareholder shall be entitled to transfer any share after any call shall have been made in respect thereof, until he shall have paid such call, nor until he shall have paid all calls for the time being due upon every share held by him," is not a general lien attaching upon all the shares held by a member, but applies merely to shares upon which calls remain unpaid; and therefore a shareholder may transfer shares upon which nothing is due, though he may be liable for calls upon others.³ A lien of this description attaches upon dividends declared,⁴

¹ 9 Mo. 153; *Leggett v. Bank of Sing Sing*, 24 N. Y. 283. Compare, however, the dissenting opinion of Allen, J.; Selden, C. J., and Sutherland, J., also dissenting. *Reese v. Bank of Commerce*, 14 Md. 271.

The lien of a corporation for debts due by its shareholders has been held to extend to debts due by a partnership of which a shareholder was a member. *Arnold v. Suffolk Bank*, 27 Barb. 425. *Re Bigelow*, 1 Nat. B. R. 667.

² *Kahn v. Bank of St. Joseph*, 70 Mo. 262. Compare *Pittsburgh, &c. R. R. Co. v. Clarke*, 29 Pa. St. 146; *supra*, § 143.

³ *Hubbersty v. Manchester, &c. Ry. Co.*, L. R. 2 Q. B. 472, in the Exchequer Chamber.

⁴ *Bates v. N. Y. Ins. Co.*, 3 Johns. Cas. 238; *Hague v. Dandeson*, 2 Exch. 741; *Hagar v. Union Nat. Bank*, 63 Me. 509.

and adheres to the proceeds of the shares after a liquidation or dissolution of the company.¹

§ 205. In *German Security Bank v. Jefferson*,² a lien was claimed by a banking corporation, under a provision of its charter that "said bank shall hold a lien on the shares of any stockholder who may be indebted to it, and such shares shall not be assigned nor transferred until the debt shall be paid or discharged." The stockholder who was indebted to the company had become insolvent, and made an assignment for the benefit of creditors. The Supreme Court of Kentucky held that the lien of the bank was "similar to the preference allowed to partnership creditors of having their debts paid out of the partnership fund before the private creditors of either of the partners can assert their claims. In the one case, the preference is given by a statutory provision, and in the other it grows out of a well-established and inexorable rule of equity practice. . . . Where such preferences are claimed, the unsecured creditors may demand that the assets shall be marshalled, and when the bank shall have applied the whole of the proceeds of the bank stock to the payment of their debts, equity demands that they shall be postponed until the general creditors have been indemnified out of the general and unencumbered estate; and when this is done, the balance will then be distributed *pari passu* among all the creditors."³

It has been held that a surety for an indebtedness which a shareholder owes to the corporation is entitled to be subrogated in place of the corporation, and to enforce its lien upon the stock, after paying the indebtedness to the company.⁴

§ 206. **When the Lien does not hold.**—The agents of a corporation cannot create a lien on the shares of its members for any purpose unauthorized by the company's charter. Thus

¹ *In re General Exchange Bank*, L. R. 6 Ch. 818.

² *German Security Bank v. Jefferson*, 10 Bush, 328.

³ *Ibid.*, 330, 331, *per Lindsay, J.*; and compare *Northern Bank of Kentucky v. Keizer*, 2 Duv. 169.

⁴ *Klopp v. Lebanon Bank*, 46 Pa. St. 88. Compare *Cross v. Phenix Bank*, 1 R. I. 39; and see *Kuhns v. Westmoreland Bank*, 2 Watts, 136; *Perrine v. Fireman's Ins. Co.*, 22 Ala. 575.

it would not be within the chartered purposes of an ordinary corporation to take a nominal assignment of a negotiable note made by a shareholder, merely for the purpose of enforcing the company's lien on behalf of the real owner of the note; and no lien can be claimed by the corporation under these circumstances.¹

A provision in a charter prohibiting transfers of shares until all debts due by the holder to the company have been discharged, does not prevent an assignment of the equitable interest in the shares, subject to the rights of the corporation.² It is clear that an existing lien cannot be divested by a mere assignment of the shares; but the corporation cannot, after having notice of the assignment, create a lien at the expense of the assignee by giving further credit to the holder upon the books.³

§ 207. **Waiver of the Lien.** — A corporation may waive its lien upon the shares of a stockholder, and the right to refuse a legal transfer of the shares until debts due the company have been discharged. Thus, if a transfer is allowed to be executed on the books, this is sufficient to indicate a waiver of any lien which the company may have upon the shares.⁴ So it has been held that, if a person is induced to advance money upon the security of shares by reason of representations made by the officers of the company that the shares are unencumbered, the company will be estopped from afterwards claiming a lien for loans made to the shareholder.⁵

In *National Bank v. Watson*,⁶ a shareholder in a company, whose charter contained a provision that no share-

¹ *White's Bank v. Toledo Fire, &c. Ins. Co.*, 12 Ohio St. 601.

² *National Bank v. Watson*, 105 U. S. 217; *St. Louis, &c. Ins. Co. v. Goodfellow*, 9 Mo. 149; *Duke v. Cahawba Nav. Co.*, 10 Ala. 82.

³ *Bank of America v. McNeil*, 10 Bush, 54; *Conant v. Reed*, 1 Ohio St. 298. See *Mechanics' Bank v. Seton*, 1 Pet. 300; and compare *People v. Crockett*, 9 Cal. 112;

Nesmith v. Washington Bank, 6 Pick. 324.

⁴ *Hill v. Pine River Bank*, 45 N. H. 300; and see *Higgs v. Northern Assam Tea Co.*, L. R. 4 Ex. 387; *In re Northern Assam Tea Co.*, L. R. 10 Eq. 458.

⁵ *Moore v. Bank of Commerce*, 52 Mo. 377.

⁶ *National Bank v. Watson*, 105 U. S. 217. Compare *Bishop v. Globe Co.*, 135 Mass. 132.

holder should be allowed to transfer his shares while indebted to the company, had pledged the certificates of his shares as security for a loan. On default of payment, the pledgee sent the certificates with a power of attorney to transfer on the books to the cashier of the company, instructing him to sell the shares. The cashier replied, making no claim of a lien on behalf of the company, and agreed to sell the shares as requested. After some further delay a portion of the shares were sold. The pledgor then became bankrupt, and the directors of the company refused to allow a transfer to be executed on the books, on the ground that he was indebted to the company. The Supreme Court of the United States held that the cashier's acts constituted a waiver of the lien, and the corporation was estopped from claiming lien upon the shares against the pledgee.

§ 208. **Liability of the Corporation to the Owner of Shares for unauthorized Transfers.** — The contract of a shareholder in a corporation cannot be rescinded without his consent, either expressed or implied; hence, if a corporation allows a transfer of shares to be executed upon its books without the consent of the owner, the latter will nevertheless remain a shareholder. Thus, in *Dewing v. Perdicaries*,¹ the shares of a shareholder in a corporation of the State of South Carolina had been confiscated during the civil war, by order of the Confederate government, and had passed into the hands of *bona fide* purchasers. Upon a bill in equity, brought by the original holder against the corporation and the purchasers of the certificates, the Supreme Court of the United States held that the confiscation and sale were illegal and void, that the complainant remained a shareholder, and that the outstanding certificates should be delivered up and cancelled.

Upon the same principle, it has been held repeatedly that, if shares in a corporation are transferred upon the books, without the consent of the holder, under a forged assign-

¹ *Dewing v. Perdicaries*, 96 U. S. Adms. v. Petersburg R. R. Co., 193. See also *Chew v. Bank of Chase's* Dec. 167. Baltimore, 14 Md. 300; Keppel's

ment or power of attorney, the real owner is not thereby divested of his rights as shareholder, and is entitled to have his shares replaced upon the books, and to recover any dividends which have accrued upon them. If the corporation refuses to recognize the real owner as a shareholder, or refuses to deliver him a new certificate of shares when entitled thereto, he may obtain specific relief by bill in equity, or may sue the company for the value of the shares.¹

§ 209. **When the Corporation may repudiate a Transfer under a forged Power.** — The agents of a corporation, in executing a transfer of shares upon the stock-books, act on behalf of all the parties to the transfer. And if a transfer is registered by such agents without the consent of the owner of the shares, the transferee cannot on that ground alone hold the company liable. Thus, where a party who had become a *bona fide* purchaser of a certificate of shares under a forged assignment obtained from the agents of the company a transfer upon the books and a new certificate, it was held that the company was entitled to repudiate the transfer upon discovering the forgery, and that the transferee had no claim against the company for damages. The mere fact that the agents of the company had registered the transfer and had issued a new certificate, did not create an estoppel on the part of the company. The company was under no obligation to inquire into the validity of the assignment on behalf of the

¹ *Telegraph Co. v. Davenport*, 97 U. S. 369, and cases cited; *Simmons v. Camp*, 71 Ga. 54; *Pratt v. Taunton Copper Manuf. Co.*, 123 Mass. 110; *Sewall v. Boston Water Power Co.*, 4 Allen, 277; *Machinists' Nat. Bank v. Field*, 126 Mass. 345; *Moses v. Watson*, 65 Ga. 196; *Baker v. Wasson*, 53 Texas, 150; *Pollock v. National Bank*, 7 N. Y. 274; *Woodhouse v. Crescent Mut. Ins. Co.*, 35 La. Ann. 238; *Johnston v. Renton*, L. R. 9 Eq. 181, 188; *Cottam v. Eastern Counties Ry. Co.*, 1 J. & H. 243; *Taylor v. Midland Ry. Co.*, 29 L. J. Ch. 731; and 8 H. L. C.

751; *Davis v. Bank of England*, 2 Bing. 393; *Swan v. North British, &c. Co.*, 7 H. & N. 603; *Hambleton v. Central Ohio R. R. Co.*, 44 Md. 551; *Sloman v. Bank of England*, 14 Sim. 475.

But the real owner may be estopped from asserting his rights through negligence. See *Coles v. Bank of England*, 10 Ad. & El. 437. Compare, however, *Davis v. Bank of England*, 2 Bing. 393; *Swan v. North British, &c. Co.*, 7 H. & N. 603; *Telegraph Co. v. Davenport*, 97 U. S. 369.

assignee, nor had the latter been deceived or misled in any manner by the acts of the company's agents; every element of an estoppel was therefore wanting.¹

§ 210. **Transfers under forged Powers.**— If the agents of a corporation have erroneously issued a certificate of shares to a person not entitled to it, it may be repudiated by the corporation, and cancelled, unless it has come into the hands of a *bona fide* purchaser.²

In *Machinists' National Bank v. Field*,³ a bill in equity was brought by a corporation to obtain the surrender and cancellation of a certificate of shares which it had been induced to issue upon the faith of a forged assignment and power of attorney. The facts of the case were as follows. A certificate of shares, with a forged assignment and power to transfer indorsed upon it, was brought to Field, a broker, for sale. Field employed Hawes & Henshaw to sell the shares at auction. Dean became the purchaser, but did not see the certificates, or know who had been the owner of the shares. Field thereupon took the certificate to the bank, and under the forged power of attorney procured a transfer to be made to Hawes & Henshaw, and a new certificate was issued in their names. Hawes & Henshaw then delivered this certificate to Dean, properly indorsed with an assignment and power to transfer, and Dean completed the purchase by paying the money for the shares, which was turned over to the party for whom they had been sold. Neither Dean, nor Field, nor Hawes & Henshaw had notice of the forgery, and all three were made defendants by the company. The Supreme Court of Massachusetts held that the company was not entitled to relief. Chief Justice Gray said: "Dean cannot be ordered to return his certificate, because he purchased the

¹ *Simm v. Anglo-American Telegraph Co.*, L. R. 5 Q. B. D. 188; *Brown v. Howard Fire Ins. Co.*, 42 Md. 384; and see *Dewing v. Perdicaries*, 96 U. S. 193; *Central R. R., &c. Co. v. Ward*, 37 Ga. 515; *Nutting v. Thomason*, 46 Ga. 34. Compare *Hart v. Frontino, &c. Mining*

Co., L. R. 5 Ex. 111; *In re Bahia, &c. Ry. Co.*, L. R. 3 Q. B. 584; *Knights v. Wiffen*, L. R. 5 Q. B. 660.

² *Houston, &c. Ry. Co. v. Van Alstyne*, 56 Texas, 440.

³ *Machinists' Nat. Bank v. Field*, 126 Mass. 345.

shares in good faith and for valuable consideration, and the certificate issued to him is, as against the bank, conclusive evidence of his title. The bank has no right to compel him, rather than any other stockholder, to give up his certificate, and thereby assume the responsibility of its own illegal act in issuing a greater number of shares than the law authorized. . . . Hawes & Henshaw claim no title to the stock, and are protected, equally with Dean, by the certificates issued to them by the plaintiff. Field also has and claims no title in the stock, and if, by reason of his having presented to the bank the forged power of attorney upon which the new certificates were issued, he is liable to the bank in any form (of which we give no opinion), the bank has an adequate remedy against him alone by action at law."¹

This decision was clearly right. The purchase by Dean at the auction sale was a contract to take so many shares in the corporation; and when he afterwards accepted a certificate of shares issued by the proper officers of the bank, and paid the price in pursuance of his agreement, he was in every sense a *bona fide* purchaser for value of this certificate. As such he was entitled to recover damages from the corporation for having misled him by the false representation contained in the certificate that the holder was entitled to the shares.²

A different case would have been presented if Dean had first purchased the shares upon the faith of the original certificate, and had afterwards procured a transfer to be registered under the forged power. In that case, he would have been misled by the forged assignment, but not by the act of the company or its agents. And, having obtained a new certificate from the company by merely surrendering another to which he had no title, there would be no reason, legal or equitable, why he should be accorded any rights under the

¹ *Machinists' Nat. Bank v. Field*, 126 Mass. 348, 349.

The corporation had been previously compelled to issue a new certificate to the real owner, whose

name had been forged. *Pratt v. Taunton Copper Manuf. Co.*, 123 Mass. 110.

² *New York, &c. R. R. Co. v. Schuyler*, 34 N. Y. 30; *infra*, § 585.

new certificate which he did not possess under the old. The corporation would therefore have been entitled to have the new certificate cancelled, lest it should pass into the hands of a *bona fide* purchaser for value.

§ 210 *a*. **The Corporation may recover Damages.** — In a subsequent case, the Supreme Court of Massachusetts held that a corporation, which had been induced to issue a new certificate for shares upon the faith of the surrender of the certificate indorsed with a forged power of attorney to execute a transfer, was entitled to recover its full damages resulting from the transfer and the issue of a new certificate, in an action against the person who had presented the forged power and caused the transfer to be executed to himself, although he had acted in good faith and without notice of the forgery.¹

§ 211. **The Corporation may require Evidence of the Transferee's Right.** — A corporation is not required to execute a transfer on demand, without having reasonable evidence of the right of the party demanding the transfer. In *Telegraph Company v. Davenport*,² Chief Justice Waite said: "The officers of the company are the custodians of its stock-books, and it is their duty to see that all transfers of shares are properly made, either by the stockholders themselves, or persons having authority from them. If, upon the presentation of a certificate for transfer, they are at all doubtful of the identity of the party offering it with its owner, or if not satisfied of the genuineness of a power of attorney produced, they can require the identity of the party in the one case, and the genuineness of the document in the other, to be satisfactorily established before allowing the transfer to be made."

§ 212. **Remedies against a Corporation for a wrongful Refusal to execute a Transfer.** — It is not difficult to determine, upon principle, what remedies should be available against a corpo-

¹ *Boston, &c. R. R. Co. v. Richardson*, 135 Mass. 473.

² *Telegraph Co. v. Davenport*, 97 U. S. 371; *Chew v. Bank of Baltimore*, 14 Md. 300; *Bayard v. Farm-*

ers', &c. Bank, 52 Pa. St. 232; and see *Loring v. Salisbury Mills*, 125 Mass. 138; *Bird v. Chicago, &c. R. R. Co.*, 137 Mass. 428.

ration which has wrongfully refused to allow a transfer to be executed on its books, but the rules established by the authorities upon this subject are not always in accordance with principle.

The right of a shareholder to transfer his shares is founded upon the implied terms of the contract of membership. Where a certificate has been issued to a shareholder in the ordinary form, his right to a transfer is also founded upon the contract set forth in the certificate, by the terms of which the corporation agrees to allow a transfer to be executed by the holder or his attorney. In either case, the shareholder's right to transfer his shares appears to be a legal right based upon contract.

An equitable assignee of shares is not a party to the contract between the shareholders, and, if no certificate for shares has been delivered to him, is not in any way in privity with the corporation. He has merely an equitable right against the corporation, by reason of his contract with the assignor and the trust created in his favor. If, however, the assignee is the purchaser of a certificate issued in the usual form, he comes in privity with the corporation, by reason of the contract contained in this certificate. The certificate is an offer by the corporation to receive any person as a shareholder who shall present the certificate properly indorsed with an assignment and power of attorney to execute a transfer.

§ 213. **Remedies of the Shareholder.**—A wrongful refusal by the agent of a corporation to allow a transfer of shares does not cancel the shares and put an end to the contract of membership; and if the shares were sold by the owner in the usual way, by delivery of the certificates, such refusal would not be a ground for rescinding the sale as between the vendor and vendee. An ordinary sale of shares is complete upon a delivery of the certificates properly indorsed, and the vendor is not responsible to the vendee for a wrongful refusal on the part of the agents of the corporation to allow a transfer on the books. It follows, therefore, that a shareholder on the books, after a sale upon the usual terms, would suffer no damages by reason of the refusal of the company to allow a

transfer on the books. His claim would at most be for nominal damages for a technical breach of contract.

But this rule would not apply under all circumstances. If, by the terms of the contract between the vendor and vendee, the sale was conditional upon the execution of a complete transfer, or if the vendor agreed with the vendee to procure a transfer of the shares, the vendor would suffer material injury, through the wrongful refusal of the agents of the company to allow a transfer. If the sale should fail by reason of this refusal, the vendor's damages would be the loss of the sale, and if he should be held liable in damages by the purchaser, he would have a claim for indemnity against the corporation.

Another case in which a shareholder would be materially injured by a refusal to allow a transfer is where the shares are not fully paid up, or where the shareholders on the books are individually liable to creditors. To allow the vendor's name to remain on the books under these circumstances may subject him to serious liability.

§ 214. A shareholder's claim against a corporation for a refusal to allow a transfer of his shares to another person appears to be a legal claim for damages, by reason of the company's breach of its express or implied contract. In some instances, however, a suit for damages would not be an adequate remedy; as, for example, where the shareholder would continue liable to creditors or to the other shareholders, while his name remained upon the company's stock-books. In a case of this kind it would ordinarily be impossible to ascertain the amount of the plaintiff's damages until after the company had become insolvent, and a judgment for damages would then be worthless. The proper remedy would therefore be a bill in equity for a specific performance of the company's contract to allow a transfer, or a bill to restrain the company's agents from violating the complainant's equitable rights as a member of the corporation.¹ The vendor's right to obtain a specific performance of the

¹ Compare *infra*, § 235 *et seq.*; 30, 39, 41; and see the cases cited *Freon v. Carriage Co.*, 42 Ohio St. in the following note.

vendee's contract to procure himself to be registered as shareholder in the vendor's place, rests upon similar principles.¹

§ 215. **Mandamus not the proper Remedy.** — It has been held in some cases that mandamus is a proper remedy to compel the officers of a corporation to execute a transfer;² but the weight of authority is the other way.³

Mandamus, being a legal remedy, ought certainly not to be granted at the suit of a merely equitable assignee; and there seems to be no good reason for granting this remedy even where a legal right to a transfer is clear. The writ of mandamus is not issued as a matter of course; as a rule, it ought not to be granted where there is another sufficient remedy, and where no public interest is involved.⁴

In *Rex v. Bank of England*,⁵ the legal owner of certain bank stock applied for a mandamus to compel the governors of the bank to permit him to execute a transfer. The application was refused, Lord Mansfield saying: "When there is no specific remedy the court will grant a mandamus, that justice may be done. But where (as in this case) an action will

¹ *Paine v. Hutchinson*, L. R. 3 Eq. 257, affirmed L. R. 3 Ch. 388; *Shepherd v. Gillespie*, L. R. 5 Eq. 293, L. R. 3 Ch. 764; *Shaw v. Fisher*, 2 De G. & Sm. 11; *Musgrave and Hart's Case*, L. R. 5 Eq. 193; *Cheale v. Kenward*, 3 De G. & J. 27. Compare *Sheppard v. Murphy*, Ir. Rep. 1 Eq. 490; *Hawkins v. Maltby*, L. R. 3 Ch. 188.

² *People v. Crockett*, 9 Cal. 112; *Green Mount, &c. Turnpike Co. v. Bulla*, 45 Ind. 1; *Townsend v. McIver*, 2 S. C. 25; *Campbell v. Morgan*, 4 Bradw. (Ill.) 105; *Cooper v. Dismal Swamp Canal Co.*, 2 Murph. (N. C.) 195. Compare *State v. Warren Foundry, &c. Co.*, 32 N. J. L. 439; and see *Swan v. North British, &c. Co.*, 7 H. & N. 603.

³ *Baker v. Marshall*, 15 Minn. 177; *State v. Rombauer*, 46 Mo. 155;

Lamphere v. United Workmen, 47 Mich. 429; *Freon v. Carriage Co.*, 42 Ohio St. 30, 39; *Ex parte Fireman's Ins. Co.*, 6 Hill, 243; *Wilkinson v. Providence Bank*, 3 R. I. 22; *People v. Parker Vein Coal Co.*, 10 How. Pr. 543; *American Asylum v. Phoenix Bank*, 4 Conn. 172; *Stackpole v. Seymour*, 127 Mass. 104; *Murray v. Stevens*, 110 Mass. 95; *State v. Guerrero*, 12 Nev. 105; *Durham v. Monumental Silver Mining Co.*, 9 Oreg. 41; *Shipley v. Mechanics' Bank*, 10 Johns. 484. Compare *Rex v. London Ins. Co.* 5 B. & Ald. 899; *Rex v. Bank of England*, 2 Dougl. 524; *Regina v. Liverpool, &c. Ry. Co.*, 21 L. J. Q. B. 284.

⁴ *Lamphere v. United Workmen*, 47 Mich. 429; *Stackpole v. Seymour*, 127 Mass. 104.

⁵ *Rex v. Bank of England*, 2 Dougl. 524.

lie for complete satisfaction equivalent to specific relief, and the right of the party applying is not clear, the court will not interpose the extraordinary remedy of a mandamus. I do not think this a clear case."

§ 216. **Remedies of an Assignee of Shares.** — There is no contract relation between an assignee of shares and the corporation, where no certificates have been issued and no transfer has been made upon the books. The assignee's rights are of a purely equitable character, as *cestui que trust* of the assignor. His only remedy, therefore, is in equity, to protect his equitable rights.¹

If, however, a certificate issued by the corporation was delivered to the assignee, he would have a legal claim against the corporation, by reason of its contract, contained in the certificate, to allow a transfer to be executed; and for a breach of this contract an action for damages would be the proper remedy. This would not, however, exclude the right of the assignee to sue in equity for the protection of his equitable rights.

The wrongful refusal of the agents of the corporation would not cancel the shares or destroy the trust. Every shareholder in the corporation, and every creditor, in case of insolvency, would have a right to object to a cancellation of shares and a rescission of the contract of membership.² It is clear, therefore, that the plaintiff, in an action for a refusal to transfer, ought not to recover the value of the shares and be allowed to withdraw, but is entitled only to his actual damages.

§ 217. **The Authorities.** — **An Assignee may recover the Value of the Shares.** — The decided cases are wholly at variance with these principles. Upon the supposed authority of the dictum of Lord Mansfield in *Rex v. Bank of England*, — a dictum apparently applicable only to the legal owner of shares, — it was held, both in the Supreme Court and the Court of Errors of New York, that an assignee of shares might maintain an action of assumpsit against the corporation for refusing to permit the shares to be transferred upon its books; and that the measure of damages in such case would be the full value

¹ See *Mechanics' Bank v. Seton*, 1 Pet. 299; and see *infra*, § 218. ² *Supra*, §§ 109, 302-310, 821.

of the shares at their highest price at any time between the refusal and the commencement of the suit.¹ This decision has been generally followed, except with regard to the measure of damages; and it may be stated as a rule, that, where a corporation refuses to allow a transfer of shares upon its books, the assignee may treat this as a conversion of his shares, and sue the company for their value.²

The objections to this doctrine have already been indicated. An equitable assignee of shares, no novation having taken place, is not in privity with the corporation, nor is the assignor discharged from his contract. A wrongful refusal to allow a transfer may be a violation of the legal rights of the assignor, who is a party to the charter contract, but it is difficult to perceive upon what principle the *assignee* can maintain an action of *assumpsit*. In *Rex v. Bank of England*,³ the application for a mandamus was made by the legal owner of the shares, and the dictum of Lord Mansfield seems to indicate that an action at law might have been brought by the assignor for the refusal of the company to allow a transfer. The assignor would, in such case, have continued to be a shareholder, and the damages would have consisted of compensation merely for whatever loss he may have suffered.⁴ There is no objection to allowing the assignee of certificates to obtain similar

¹ *Commercial Bank v. Kortright*, 22 Wend. 348; 20 Wend. 91. See, however, the strong dissenting opinion of Chancellor Walworth, 22 Wend. 350-360.

² *Baltimore, &c. Ry. Co. v. Sewell*, 35 Md. 238; *Scripture v. Frankestown Soapstone Co.*, 50 N. H. 571; *De Comeau v. Guild Farm Oil Co.*, 3 Daly, 218; *Arnold v. Suffolk Bank*, 27 Barb. 424; *Bank of America v. McNeil*, 10 Bush, 54; *Pinkerton v. Manchester, &c. R. R. Co.*, 42 N. H. 424; *Sargent v. Franklin Ins. Co.*, 8 Pick. 90; *Wyman v. American Powder Co.*, 8 Cush. 168; *Helm v. Swiggett*, 12 Ind. 194; *Merchants' Nat. Bank v. Richards*, 6 Mo. App.

461; *West Branch, &c. Canal Co.'s Appeal*, 81* Pa. St. 19; *German Union Building, &c. Ass. v. Sendmeyer*, 50 Pa. St. 67; *North America Building Ass. v. Sutton*, 35 Pa. St. 463; *Protection Life Ins. Co. v. Osgood*, 93 Ill. 69. Compare *National Bank of New London v. Lake Shore, &c. Ry. Co.*, 21 Ohio St. 221; *Townsend v. McIver*, 2 S. C. 25; *Morrison v. Gold Mt. Mining Co.*, 52 Cal. 307; *Hawkins v. Mansfield Mining Co.*, Id. 513.

³ 2 Dougl. 524-526.

⁴ See *per* Chancellor Walworth in *Commercial Bank v. Kortright*, 22 Wend. 355, 356.

relief.¹ But according to the decision in *Kortright v. Commercial Bank*, and similar cases, the refusal of the agents of a corporation to allow a transfer to be executed seems to operate as a cancellation of the shares, and the equitable assignee becomes entitled to withdraw from the capital of the company the full amount of the shares. The agents of a corporation are thus enabled to accomplish indirectly what they certainly cannot do directly; namely, to diminish the capital stock of the company, by allowing individual members to withdraw with their ratable shares of the company's assets.²

§ 218. **Jurisdiction in Equity to enforce Sales and Transfers of Shares.** — Several distinctions must be observed in determining the jurisdiction of a court of equity to enforce the right of a purchaser or equitable owner of shares.

It is first to be observed, that a contract to buy and sell shares, or any other kind of property, cannot be specifically enforced, if an action at law for damages would give adequate relief. This rule applies equally to an agreement made by a shareholder to sell and transfer his shares, and an agreement by a corporation to issue shares to an applicant, or to receive him as a shareholder thereafter.³ In either case, the purchaser has a legal remedy against the vendor upon his contract to sell and deliver.⁴ But a court of equity will grant

¹ *Supra*, § 216.

² See *supra*, § 109 *et seq.*, and also *Burrall v. Bushwick R. R. Co.*, 75 N. Y. 216.

An assignee of shares who has elected to treat the refusal of the corporation to allow a transfer as a conversion of the shares cannot thereafter sue for dividends. *Hughes v. Vermont Copper Mining Co.*, 72 N. Y. 207.

The wrongful refusal of the agents of a corporation to issue to a shareholder a certificate of shares, and to permit him to execute a transfer on the books, is not a ground for rescinding a bond and mortgage given to the company for the shares, nor can he

recover back the amount paid. His only remedy is an action on the case for the value of the shares. *Thorp v. Woodhull*, 1 Sandf. Ch. 411; *Battershall v. Davis*, 31 Barb. 323; *Arnold v. Suffolk Bank*, 27 Barb. 424.

³ See *supra*, § 61.

⁴ See *Ross v. Union Pacific Ry. Co.*, 1 Woolw. 26, 32; *Cud v. Rutter*, 1 P. Wms. 570; s. c. 1 White & Tudor's Leading Cases, 786; *Mason v. Armitage*, 13 Ves. 37. See also *Foll's Appeal*, 91 Pa. St. 434; *Noyes v. Marsh*, 123 Mass. 287; *Strasburg R. R. Co. v. Echternacht*, 21 Pa. St. 220; *Ferguson v. Paschall*, 11 Mo. 267. Compare the cases cited in the following note.

specific performance of a contract to sell and deliver property, if the legal remedy would not be adequate. If a corporation or a shareholder has entered into a contract to sell and deliver shares, and these shares are of such a character that similar shares cannot be procured elsewhere, a court of equity will ordinarily enforce a specific performance of the contract at the suit of the purchaser.¹

§ 219. **Equity will protect the Rights of an equitable Owner.** — A bill in equity brought by an equitable owner of shares against the holder of the legal title must be distinguished from a bill for the specific performance of a contract. If shares are held by a corporation or individual upon an express or implied trust for another, a court of equity will always furnish a remedy to the *cestui que trust* against the trustee, to protect his equitable right and to obtain a transfer of the legal title. Under these circumstances, the jurisdiction in equity does not depend upon special circumstances, as where specific performance of a *legal* obligation is sought, but upon the ground that the plaintiff's rights are cognizable only in equity.²

§ 220. **Remedy of an equitable Assignee against the Corporation.** — There is no contract between a mere assignee of a certificate of shares and the corporation, except perhaps the contract contained in the certificate by which the corporation

¹ *Ashe v. Johnson*, 2 Jones Eq. (N. C.) 155; *Austin, &c. R. R. Co. v. Gillaspie*, 1 Jones Eq. (N. C.) 261; *White v. Schuyler*, 1 Abb. Pr. n. s. 300; s. c. 31 How. Pr. 38; *Gardener v. Pullen*, 2 Vern. 394; *Doloret v. Rothschild*, 1 Sim. & St. 598; *Duncuft v. Albrecht*, 12 Sim. 198, 199; *Adderley v. Dixon*, 1 Sim. & St. 610; *Poole v. Middleton*, 29 Beav. 646; *Parish v. Parish*, 32 Beav. 207; *Beckitt v. Bilbrough*, 8 Hare, 188; *Frue v. Houghton*, 4 Leg. Adv. 108; *Treasurer v. Commercial Mining Co.*, 23 Cal. 390. Compare *Wonson v. Fenno*, 129 Mass. 405; *Leach v. Fobes*, 11 Gray, 506; *Baldwin v. Commonwealth*, 11 Bush (Ky.), 417.

A decree of specific performance is of course improper if performance is impossible, as where the defendant has no shares to deliver. *Ferguson v. Wilson*, L. R. 2 Ch. App. 87; *Columbine v. Chichester*, 2 Phil. 27. Compare *Poole v. Middleton*, 29 Beav. 646.

² *Cowles v. Whitman*, 10 Conn. 121; *Johnson v. Brooks*, 46 N. Y. Super. Ct. 13, affirmed 93 N. Y. 337; *Weaver v. Barden*, 49 N. Y. 286; *Draper v. Stone*, 71 Me. 175; *Todd v. Taft*, 7 Allen, 371; *Forrest v. Elwes*, 4 Ves. 497. Compare *Wonson v. Fenno*, 129 Mass. 405; *Fowle v. Ward*, 113 Mass. 548. See also cases *supra*, §§ 175, 181.

agrees to allow a transfer on the books to be executed by any person who shall surrender the certificate, duly indorsed. In the absence of this contract, the assignee would, upon principle, have no *legal* rights against the corporation, and his only remedy would be in equity. Accordingly, in *Mechanics' Bank v. Seton*,¹ a bill in equity, brought by a *cestui que trust* of shares to compel the corporation to allow a transfer on the books to be executed by the trustee to the complainant, was sustained.

It has often been held that a legal owner of shares may maintain a bill in equity to compel the corporation to issue a certificate, and accord to him the rights of membership, where an attempt has been made to deprive him of his shares through an unauthorized transfer.² There seems to be even greater propriety in sustaining a proceeding of this description at the suit of a merely equitable assignee of shares. It should be observed, however, that inasmuch as it has been decided that an assignee of a certificate for shares has a right to proceed at law against the corporation, and recover the value of his shares, upon a refusal of the corporation to allow a transfer on the books, it cannot now be denied that he has in fact a remedy at law, although perhaps not in all cases an adequate one.³

¹ *Mechanics' Bank v. Seton*, 1 Pet. 299, 304. Mr. Justice Thompson said: "If this had been a bill, filed against the bank, to compel a specific performance of any contract entered into with it for the sale of stock, it might then be urged that compensation for a breach of the contract might be made in damages, and that the remedy was properly to be sought in a court of law. But the bill does not set up any contract between the complainants and the bank; nor does it seek a specific performance of any express contract whatever, entered into with the bank. It only asks that the bank may be compelled to open its transfer-book, and permit Adam Lynn to transfer the stock. By the charter and by-

laws of the bank, such transfer could only be made on the books of the bank; and it was by their consent alone that this could be done. Although it might be the duty of the bank to permit such transfer, it would be difficult to sustain an action at law for refusing to open its books and permit a transfer." Compare *Iron R. R. Co. v. Fink*, 41 Ohio St. 321.

² See cases *supra*, § 208.

³ See *Cushman v. Thayer Manuf., &c. Co.*, 76 N. Y. 365, affirming 7 Daly, 330; *Iasigi v. Chicago, &c. R. R. Co.*, 129 Mass. 46; *American Asylum v. Phoenix Bank*, 4 Conn. 172. Compare *Walker v. Detroit, &c. Ry. Co.*, 47 Mich. 338.

§ 221. If a purchaser or equitable owner of shares is entitled in equity to compel the corporation to receive him as a shareholder, and the agents of the corporation wrongfully refuse to allow a complete transfer to be executed, or if any formalities remain unperformed through their fault, the purchaser or equitable owner may, nevertheless, compel the corporation to accord to him all the rights of a shareholder. Under these circumstances, the corporation would be responsible for the wrongful acts of its agents,¹ and justice is best served by considering that done which ought to have been done, and settling the rights of the parties accordingly.²

§ 222. *Irregular Transfers. — Ratification.* — A provision in the charter or general laws under which a corporation was formed, prescribing a particular method of executing transfers of shares, constitutes a part of the agreement between the shareholders under the charter, and cannot be disregarded without their consent; a transfer made without the prescribed formalities would be unauthorized, and, as a general rule, would not bind the company.³

But, as will be shown hereafter, the fact that a corporate act is unauthorized, or is even in violation of the company's charter, is not necessarily fatal to its validity.⁴ A provision directing transfers of shares to be executed in a particular manner is intended merely for the convenient regulation of the corporate affairs, for the benefit of the shareholders, and the latter may waive compliance with a provision of this kind, or render binding an irregular and unauthorized transfer by their subsequent ratification. This rule applies equally whether the forms of transfer are prescribed by the company's charter or by the by-laws adopted by vote of the majority.

If a particular method of transfer has been adopted by custom and the general acquiescence of the shareholders, a

¹ *Supra*, § 217.

² See *Robinson v. National Bank*, 95 N. Y. 637; *Isham v. Buckingham*, 49 N. Y. 216, 223; *Chouteau Spring Co. v. Harris*, 20 Mo. 382, 390; *Johnson v. Laffin*, 5 Dill. 65. Compare

Nation's Case, L. R. 3 Eq. 77; *Weston's Case*, L. R. 4 Ch. 20; *Fyfe's Case*, L. R. 4 Ch. 768; *Lowe's Case*, L. R. 9 Eq. 589.

³ *Infra*, § 719.

⁴ *Infra*, § 723.

transfer executed according to the customary method is binding, although not in strict accordance with the charter and by-laws.¹ And it may be laid down as a rule, that any transfer is binding, after it has been acted upon by the transferor and transferee, and ratified by the shareholders by receiving the transferee as a shareholder in place of the former member.²

§ 223. **When irregular Transfer binds Transferee.** — It is clear that a person cannot be constituted a shareholder in a corporation by a transfer of shares, without his consent. A transfer of shares to a person who does not consent to accept them, or who is unable to become a shareholder, is simply null and void, and the transferor remains the holder of the shares.³

But a person who has voluntarily accepted a transfer cannot afterwards impeach its validity upon the sole ground that the formalities prescribed by the company's charter have not been observed. The formalities of a transfer are of no importance except as conditions precedent to the consent of the corporation; they merely indicate the methods by which the shareholders have agreed to receive new members. If the corporation has given its *actual* consent to a transfer by the unanimous acquiescence or ratification of its shareholders, it is immaterial whether the formalities indicated by the charter have been observed or not.

Of course a transferee of shares is not bound by the transfer unless the corporation is bound. A contract is not binding upon either party until both have consented to be bound. If a transfer is unauthorized by reason of an informality, the

¹ Compare *Chambersburg Ins. Co. v. Smith*, 11 Pa. St. 120; *Isham v. Buckingham*, 49 N. Y. 216; and see *infra*, § 657. Conn. 487; *Home Stock Ins. Co. v. Sherwood*, 72 Mo. 461; *Isham v. Buckingham*, 49 N. Y. 216. See also *Walters's Case*, 3 De G. & Sm.

² *Laing v. Burley*, 101 Ill. 591; *Cutting v. Damerel*, 88 N. Y. 410; *Chambersburg Ins. Co. v. Smith*, 11 Pa. St. 120; *Smock v. Henderson*, 1 Wils. (Ind.) 241; *Weber v. Fickey*, 52 Md. 501, 516. Compare *Richmondville Manuf. Co. v. Prall*, 9

³ *Henessey's Executors' Case*, 3 De G. & Sm. 191; 2 Macn. & G. 201; *Gustard's Case*, L. R. 8 Eq. 438; *Cartmell's Case*, L. R. 9 Ch. 691; *Capper's Case*, L. R. 3 Ch. 458.

transferee will be at liberty to withdraw at any time before the corporation has ratified the transfer, or in some manner consented to receive the transferee as shareholder.

§ 224. **The Legal Character of Shares. — Not Real Estate. —** Shares in a corporation are not real estate, even where the corporation is the owner of real property. The rights of a shareholder are rights of contract. The title to the company's property is vested in the corporation as a body; the right of each shareholder is merely an equitable right to have the entire property managed in accordance with the charter, and, after the dissolution of the company, to have the assets reduced to cash and distributed.¹ Hence it has been held that shares are not real estate within the meaning of a mortmain act;² nor are they interests in land, within the Statute of Frauds, even where the corporation owns land.³ Upon the death of the owner, shares in a corporation pass to the executor, and not to the heir,⁴ and they are not subject to the right of dower.⁵

In most of the States it is provided by general law that shares in a corporation shall be treated as personal property. A provision of this description is merely declaratory of the common law. It relates "merely to the nature or character of the property which the stockholders are to be deemed to have in the several shares of stock of the company as individuals, and not to the character of the property held by the company in its corporate capacity for the benefit of such stockholders."⁶

Shares in a corporation are not real estate within the meaning of the statute prohibiting national banks from loaning

¹ *Infra*, Chapter V.

² *Edwards v. Hall*, 6 De G., M. & G. 74; *Thompson v. Thompson*, 13 L. J. Ch. 455; *Ashton v. Langdale*, 20 L. J. Ch. 234; *Hilton v. Giraud*, 1 De G. & Sm. 183; *Baker v. Sutton*, 1 Keen, 234; *March v. Atty-Gen.*, 5 Beav. 433; *Hayter v. Tucker*, 4 K. & J. 243.

³ *Bradley v. Holdsworth*, 3 M. & W. 422. See also *Humble v.*

Mitchell, 11 A. & E. 205; *Powell v. Jessopp*, 18 C. B. 336; *Watson v. Spratley*, 10 Ex. 222; *Bligh v. Brent*, 2 Y. & C. Ex. 268.

⁴ *Hutchins v. State Bank*, 12 Metc. (Mass.) 426; *Bligh v. Brent*, 2 Y. & C. Ex. 268, 294. *Contra*, *Welles v. Cowles*, 2 Conn. 567.

⁵ *Johns v. Johns*, 1 Ohio St. 350.

⁶ *Mohawk, &c. R. R. Co. v. Clute*, 4 Paige, 384, 393.

money on real estate security, although the entire property of the corporation be real estate.¹

§ 225. **Shares are Choses in Action and Personal Property.**—It has been pointed out that shares in a corporation are mere contract rights, or, in technical language, choses in action.² Hence it has been held that, at common law, a husband must reduce shares standing in his wife's name into possession, in order to obtain an absolute title thereto.³ And, for the same reason, shares cannot be levied upon as chattel property, under an execution directed against the holder, in the absence of a statute authorizing this procedure.⁴

But shares are clearly "property," within the broad meaning of that term. They have been held to be "personal property" subject to tax laws,⁵ and to pass as "personal property" under a will.⁶

§ 226. **The Legal Character of a Certificate for Shares.**—**Statute of Frauds.**—A distinction must be observed between shares, considered abstractly, as the sum of the shareholder's rights, and the transferable certificates which represent these rights. The rights of a shareholder are mere contract rights, or choses in action, but the certificates are something more. They are constantly treated as tangible property in commercial transactions, and, by reason of their negotiable character, are in fact tangible property of great value, just as negotiable notes and bills are.⁷ An action of trover may be brought for the conversion of a certificate of shares, as for the conversion of a promissory note,⁸ and it has been rightly held that shares may be the subject of a gift *causa mortis* by delivery of the certificates.⁹

¹ Baldwin v. Canfield, 26 Minn. 43.

² *Supra*, Chapter II.

³ Arnold v. Ruggles, 1 R. I. 165; Slaymaker v. Bank, 10 Pa. St. 373. See King v. Capper, 5 Price, 217.

⁴ Van Norman v. Circuit Judge, 45 Mich. 204; Howe v. Starkweather, 17 Mass. 240; Denton v. Livingston, 9 Johns. 96; Planters' &c. Bank v. Leavens, 4 Ala. 753.

⁵ Griffith v. Watson, 19 Kans. 23; Union Bank v. State, 9 Yerger, 490; Waltham Bank v. Waltham, 10 Metc. (Mass.) 334.

⁶ Cadman v. Cadman, L. R. 13 Eq. 470.

⁷ *Supra*, §§ 186-190.

⁸ Kuhn v. McAllister, 1 Utah Ter. 273.

⁹ Grymes v. Hone, 49 N. Y. 17; Walsh v. Sexton, 55 Barb. 251.

The authorities are not clear as to the application of the seventeenth section of the Statute of Frauds, relating to contracts for the sale of "goods, wares, and merchandise," to contracts for the sale of shares. The distinction between shares and certificates of shares appears to have been overlooked. Shares, independently of the certificates, can certainly not properly be considered either "goods," or "wares," or "merchandise," within the meaning of the statute, as these terms are intended to apply only to property capable of physical delivery. But certificates for shares are tangible property, and are the subject of barter and sale, like other property capable of delivery. They ought therefore to be considered "goods" and "merchandise," within the meaning of the statute. The proper rule would seem to be that a contract for the assignment of shares (not meaning certificates of shares) is not subject to the statute;¹ but a contract for the sale and delivery of a certificate of shares, in the ordinary form, is governed by the same rule as a contract for the sale of other goods, wares, or merchandise.²

¹ *Humble v. Mitchell*, 11 A. & E. 205; *Watson v. Spratley*, 10 Exch. 222; *Bowlby v. Bell*, 3 C. B. 284; *Duncuft v. Albrecht*, 12 Sim. 198; and see *Pickering v. Appleby*, Comyn, 354. Compare also *Knight v. Barber*, 16 M. & W. 66; *Lawton v. Hickman*, 9 Q. B. 563; *Somerby v. Buntin*, 118 Mass. 279; *Whittemore v. Gibbs*, 24 N. H. 484.

² Compare *Tisdale v. Harris*, 20 Pick. 13; *Boardman v. Cutter*, 128 Mass. 388; *North v. Forest*, 15 Conn.

400; *Fine v. Hornsby*, 2 Mo. App. 61; *Pray v. Mitchell*, 60 Me. 430.

The same rule should apply to contracts for the sale of negotiable paper. *Baldwin v. Williams*, 3 Metc. (Mass.) 365.

In the United States a contract for the sale of "shares" is usually understood to mean a contract for the sale of certificates, properly issued and indorsed, with an assignment and power of attorney.

CHAPTER V.

RIGHTS AND REMEDIES OF SHAREHOLDERS.

PART I.

THE RELATION BETWEEN A CORPORATION AND ITS SHAREHOLDERS.

§ 227. **The Uses of the Fiction of a Separate Corporate Entity.**—A clear perception of the real nature and constitution of an incorporated association is of the utmost importance in considering the rights and obligations of the individual shareholders, and their relation to the association as a body. It is especially necessary that the legal fiction by which a corporation is regarded as a person, or entity, apart from its several members, be correctly understood and applied.

The statement that a corporation is an artificial person, or entity, apart from its members, is merely a description, in figurative language, of a corporation viewed as a collective body: a corporation is really an association of persons, and no judicial dictum or legislative enactment can alter this fact.¹ It is true that the courts of law, as distinguished from the courts of equity, do not, as a rule, look beyond the fiction of a separate corporate entity. The individual shareholders are not, in contemplation of law, parties to obligations entered into by the association in a corporate capacity, nor have they any legal right or interest in the property vested in the corporation as a body. At law, a corporation and its shareholders are considered as entirely distinct from each other, and the contractual relation between the shareholders

¹ *Supra*, § 1.

is ignored; only the corporate rights and obligations are recognized. It follows for this reason that the courts of law are in many instances unable to protect the rights of the shareholders in a corporation, and that the assistance of the courts of equity is necessary to the attainment of justice.¹

It is not to be understood that the courts of equity do not also regard a corporation as a collective body. On the contrary, a corporation is ordinarily viewed as a distinct entity in equity as well as at law, and in the dealings of business men. It would be absolutely impossible to conceive of corporate rights and obligations except by means of the abstraction of a corporate entity, and the use of the corporate name as a symbol representing this abstraction. The corporate or collective rights and obligations of an association must, in the nature of things, be treated as rights and obligations of the association taken collectively. So, although the rights and obligations attaching to the individual shareholders, by reason of their contract of association, are in reality rights and obligations between the shareholders, yet they can be measured and enforced only by regarding them as rights and obligations between the individual shareholders and the association as an entity. In this respect the same rule applies in equity and at law.

But there is this difference. In equity the conception of a corporate entity is used merely as a formula for working out the rights and equities of the real parties in interest; while at law this figurative conception takes the shape of a dogma, and is often applied rigorously, without regard to its true purpose and meaning. In equity the relationship between the shareholders is recognized whenever this becomes necessary to the attainment of justice; at law this relationship is not recognized at all.

It is interesting, in this connection, to compare the legal status of a partnership with that of a corporation. The rights and obligations of partners are in many respects collective, and can be measured and enforced only by viewing them collectively. But the courts of law recognize the

¹ See, for example, *infra*, § 237.

members of a partnership only as individuals, standing in a contractual relation to each other; they do not recognize the partners as a firm or collective body. The converse is true in the case of a corporation, and in both instances the machinery of the courts of law is frequently inadequate to the attainment of justice.

§ 228. *Instances when the Relation has been recognized.*— It will be instructive, before considering the rights and obligations of the individual shareholders of a corporation with regard to their mutual relationship, to refer to some of the instances in which the real character and constitution of a corporation must be considered in determining the rights and obligations of persons who are not members of the corporation.

It is well settled that, after an unauthorized act of the agents of a corporation has been ratified by the unanimous consent of the shareholders, it will be binding to the same extent as if it had been fully authorized by the corporation.¹ In this instance the identity of a corporation and the whole number of its shareholders is recognized even by the courts of law.

The previous assent of all the shareholders of a corporation has the same consequences as a subsequent ratification; it is in fact and in law the assent of the company. Thus in *Des Moines Gas Co. v. West*,² a corporation sought to pro-

¹ *Infra*, § 603.

² *Des Moines Gas Co. v. West*, 50 Iowa, 16, 25. Beck, J., delivering the opinion, said: "Can it be doubted that Allen [the president] would not be heard should he come into a court of equity, asking that the bonds and deed of trust be set aside and held for naught, on the ground that they were executed through his own fraud, that the gas company possessed no authority to execute the instruments, and that, under the doctrine of *ultra vires*, they are void? Equity would say to him, 'You cannot protect the prop-

erty of the corporation, which you own through your shares of stock, from responding to the claims of men whom you have attempted to defraud. If the deed of trust is not enforced, you will hold the property, and thus gain by your dishonest acts what you led others to believe you had secured to them.' Equity will not be bound by the technical rules of law, when these rules will permit fraud to triumph. The legal rules which regard a corporation as an artificial person, to be bound only by acts done in accord with its charter, which permit it to hold

cure the cancellation of certain bonds which had been issued by the president of the company, in direct violation of its charter. It appeared that a very large part of the company's shares were held by the president himself at the time when the bonds were issued, and that the holders of all the remaining shares knowingly acquiesced in his unlawful transactions. The Supreme Court of Iowa held that the securities were binding upon the company for this reason.

§ 229. As a general rule, a corporation is not affected by the personal rights and obligations and transactions of the shareholders who form the corporation. Yet this rule cannot be applied blindly; a court of equity will look beyond the technical doctrine whenever this becomes necessary to do justice between the parties.¹

Notice to all the shareholders in a corporation should under ordinary circumstances be held binding upon the association in its corporate capacity.²

If an association of persons owning property subject to equitable claims obtains an act of incorporation, the property will remain subject to these claims after it is vested in the corporate name; and if the company should afterwards consolidate with another corporation, the consolidated company will take the property subject to the same equities.³

property as a natural person, and limit the interest of the shareholder therein to his shares, must all go down when they are attempted to be used as instruments of fraud by the dishonest, and stand in the way of equity."

¹ Compare Appeal of Third Reformed Dutch Church, 88 Pa. St. 503.

In *Davis, &c. Wheel Co. v. Davis, &c. Wagon Co.*, 20 Fed. R. 699, 700, Wallace, J., said: "The liberal facilities offered by the statutes of many of our States for organizing such corporations are undoubtedly often utilized by those whose only object is to escape liability as part-

ners by calling themselves stockholders or directors. Where such a concern is formed, a court of equity might treat the associates as partners in fact, disregard the fiction of a corporate relation between them, and subject the title of the property transferred to it by the promoters to any equities which might have existed as against them." See *infra*, § 234.

² Compare, however, *Merchants' Steam Navigation Co. v. Eastern Steamboat Co.* (U. S. D. C.), 8 Monthly Law Rep. 91, 94; and see *infra*, § 234.

³ *Schutte v. Florida Central R. R. Co.*, 3 Woods, 692.

§ 230. Other instances in which the courts are obliged to take cognizance of the real nature of corporations, and to treat them as associations of persons, may be found in cases involving the constitutionality of legislation affecting corporations,¹ and the law relating to the dissolution² and consolidation³ of companies. The law upon these subjects is quite unintelligible, unless the real character and constitution of a corporation are clearly understood.

§ 231. Even in those cases in which only corporate rights and obligations are involved, and the corporation is nominally interested only as an entity, the courts are constantly obliged to consider that the real persons in interest are the individual shareholders.⁴ This is especially true in dealing with the rights of creditors,⁵ and the obligations existing between a corporation and its shareholders by reason of their contract of membership.⁶

The courts of equity will often take notice of the real character and constitution of a corporation in applying the doctrine of laches against persons asserting equitable claims against the company's property or assets. The shareholders in a corporation are undoubtedly bound by the corporate acts, and cannot set up their several equities against persons who have claims against the corporation; but the fact that shares represent undivided interests in the corporate concern, and are freely transferable in the open market, passing from day to day into the hands of innocent purchasers, may be a good reason why persons having equitable claims, the enforcement of which would impair the value of the company's shares, should be diligent to assert their rights. Thus, if a corporation should obtain title to property through a fraud

¹ *Infra*, Chapter XV.

² *Infra*, Chapter XIV. See *Shorb v. Beaudry*, 56 Cal. 446; *Bailey's Appeal*, 96 Pa. St. 253.

³ *Infra*, Chapter XII.

⁴ A shareholder in a corporation organized for pecuniary profit has an insurable interest in the corporate property. *Warren v. Davenport Fire Ins. Co.*, 31 Iowa, 464; *Sea-*

man v. Enterprise, &c. Ins. Co., 18 Fed. R. 250; *contra*, *Riggs v. Commercial Mut. Ins. Co.*, 51 N. Y. Super. Ct. 466.

Under the former law a shareholder was disqualified from testifying in favor of the corporation by reason of interest.

⁵ See *infra*, § 798 *et seq.*

⁶ See *infra*, §§ 302-315.

on the part of its agents, the rightful owner of the property would certainly be entitled to set aside the transfer, although innocent shareholders and creditors should suffer thereby, provided he was not guilty of inexcusable delay in asserting his rights;¹ but any negligent or unexcused delay until innocent persons have acquired an equitable interest in the property, as shareholders or creditors of the corporation, would be a sufficient reason for refusing relief in a court of equity.²

§ 232. **Instances when the Corporation must be treated as a separate Entity.** — It has been pointed out, that the fiction by which a corporation is treated as an entity distinct from its shareholders has its important uses. In many instances, the application of this fiction is absolutely essential; and it may be laid down as a general rule, that the convenient administration of justice is best served by treating a corporation as a collective entity, without regard to its individual shareholders, in all cases except those in which the equitable rights and liabilities of the shareholders cannot be ascertained and enforced without considering the real relation existing between the parties.

Liabilities incurred by parties in a corporate capacity are materially different in their scope and effect from liabilities incurred in a personal capacity, whether severally or jointly, or as partners. It is a question of intention whether the parties have incurred a liability of the one class or the other, and the intention of the parties is indicated by the form in which they have contracted or acted. If persons use a corporate name or form in entering into a contract, this indicates that they intend to contract as a corporation, and not personally;³ and if they enter into a contract under a firm name, or individually, this is *prima facie* evidence that they intend to be bound personally. This distinction must be observed

¹ *Pacific R. R. Co. v. Missouri* v. *New York, &c. R. R. Co.*, 13 *Pacific Ry. Co.*, 111 U. S. 505. *R. I.* 260; *Peabody v. Flint*, 6 *Allen*, 52, 57. Compare *Knoxville v. R. R. Co.*, 3 *Fed. R.* 177; *United States v. San Jacinto Tin Co.*, 23 *Fed. R.* 279; *Boston, &c. R. R. Co.*

² See *Wetmore v. St. Paul, &c. R. R. Co.*, 3 *Fed. R.* 177; *United States v. San Jacinto Tin Co.*, 23 *Fed. R.* 279; *Boston, &c. R. R. Co.*

³ Compare *infra*, § 728.

even where all the shares in a corporation are held by a single person; his transactions in the corporate name would differ in substance and legal effect, as well as in form, from those entered into personally. In all cases it is indispensable that the fiction of a corporate entity apart from the individual shareholders be preserved unimpaired, in measuring and enforcing those rights and obligations which are of a corporate character.¹

§ 233. It is of great importance that the title to property be kept free from complication or uncertainty. The title to property vested in a corporation should therefore not be affected by acts of the shareholders, except when acting in the corporate name. Although all the shares in a corporation belong to a single person, and there are no creditors, a conveyance or transfer by the sole shareholder, in his own name, of property vested in the corporate name, would not affect the legal title. The title would in legal contemplation remain in the fictitious entity called the corporation, irrespective of the equities which the transaction might give rise to.²

§ 234. A corporation consists of the whole number of its shareholders, and it would clearly be inequitable to charge the company as a body with the wrongful acts of a portion merely of the shareholders.³ It would likewise be impossible to do justice by partitioning the rights of the shareholders, and separating the interests of the guilty from those of the innocent. The interest of each shareholder is in the concern as a whole, and can be protected only by preserving the corporate rights in their entirety.

The transferable nature of shares is also a good reason why the fiction of a corporate entity should be preserved, and why it is necessary, as a rule, to define sharply between the corporate rights and obligations, and those of the share-

¹ Compare *New York Iron Mine v. First Nat. Bank of Negaunee*, 262; *Murphy v. Hanrahan*, 50 Wis. 485; *Bundy v. Iron Co.*, 38 Ohio St. 39 Mich. 644; *Bristol Milling, &c. Co. v. Probasco*, 64 Ind. 406. 300; *Frank v. Drenkhahn*, 76 Mo. 508.

² *Baldwin v. Canfield*, 26 Minn. 43; *Button v. Hoffman*, 61 Wis. 20; *Durant v. Kennett*, L. R. 5 C. P. ³ The above statement presupposes that the wrong-doers have not been authorized to bind the company as agents.

holders personally. A purchaser of shares in a corporation looks upon the corporation as an institution having separate interests and rights, and managed according to certain prescribed rules. In many instances, the purchaser would have no knowledge of the other shareholders, and to allow the corporate interests to be affected by personal acts and obligations of the shareholders would defeat his just expectations. The corporate affairs should therefore be managed without regard to the particular individuals who for the time being compose the company; and this is true even where no immediate injustice would be caused by treating the corporation and its shareholders as identical. Thus, the shareholders of a corporation have no right, even by unanimous consent, to divide the company's capital among themselves, with the intention of continuing business with a fictitious capital; such action would be a fruitful source of frauds thereafter, and would be in violation of the established rules for the government of corporate affairs, even though no person should be wronged thereby immediately.¹

It is for similar reasons that a corporation ought not as a rule to be charged with wrongs done or liabilities incurred before the company was formed, by the persons who afterwards became its promoters and shareholders.²

So it is a well settled rule, that notice to the promoters and shareholders of a corporation is not necessarily notice to the corporation as a body. The individual promoters and shareholders are not agents of the company, and it would be unjust to innocent members present and future to allow their rights to be prejudiced by notice to those who have received no authority to represent them, or to bind them by their acts.³

¹ The nature of the rights and causes of action arising from a transaction of this description will be considered hereafter. *Infra*, §§ 288-291. As to the rights of creditors, see *infra*, § 798 *et seq.*

² See *Morrison v. Gold Mountain Gold Mining Co.*, 52 Cal. 306; *Hawkins v. Mansfield Gold Mining*

Co., 52 Cal. 513; *Burt v. Batavia Paper Manuf. Co.*, 86 Ill. 66; *Merchants' Steam Nav. Co. v. Eastern Steamboat Co.*, 8 Monthly Law Rep. 91; *Gent v. Manufacturers', &c. Ins. Co.*, 107 Ill. 652; and see *infra*, § 525.

³ In *Davis, &c. Wheel Co. v. Davis, &c. Wagon Co.*, 20 Fed. R.

PART II.

RIGHTS AND REMEDIES OF SHAREHOLDERS.

§ 235. **Distinction between Individual and Collective Rights of Shareholders.** — There is an important distinction between those rights which belong to the shareholders individually or severally, and those which belong to them collectively or in their corporate capacity. Rights of the former class are treated as rights *against* the corporation, and may be enforced by each shareholder separately. Rights of the latter class are not severable; they are rights *in the corporate concern* rather than rights *against* the corporation, and can be enforced only through the corporate organization.

Thus, after a dividend has been declared by the agents of a corporation, each shareholder has a separate individual right to the amount payable on his shares; and this right may be enforced by an action against the company for damages.¹ On the other hand, if the agents of the company should wrongfully refuse to declare a dividend when it is their duty to distribute the profits, this would infringe the collective

699, 700, Wallace, J., said: "A corporation can have no agents until it is brought into existence, and after that it acts and becomes obligated only through the instrumentality of its authorized representatives. Stockholders cannot bind it except by their action at corporate meetings; and it is undoubted law that notice to individual stockholders is not notice to the corporation, and their knowledge of facts is not notice of them to the corporation." *Merchants' Steam Nav. Co. v. Eastern Steamboat Co.* (D. C. U. S.), 8 Monthly Law Rep. 91; *Burt v. Batavia Paper Manuf. Co.*, 86 Ill. 66; *Housatonic Bank v. Martin*, 1 Metc.

(Mass.) 294; *Custer v. Tompkins County Bank*, 9 Pa. St. 27; *Bank of Pittsburgh v. Whitehead*, 10 Watts, 402; *Union Canal Co. v. Loyd*, 4 Watts & S. 393; *Fairfield County Turnpike Co. v. Thorp*, 13 Conn. 182; *In re Carew's Estate Act*, 31 Beav. 39.

Service of process on a shareholder does not make the corporation a party to a proceeding unless the shareholder be an agent of the company. *Bache v. Nashville, &c. Soc.*, 10 Lea (Tenn.), 436; *Lillard v. Porter*, 2 Head, 178.

¹ *Infra*, § 430. *Jackson v. New-ark Plank Road Co.*, 31 N. J. Law, 277, 280.

rights of the shareholders, but not their individual rights. No shareholder could sue for any particular portion of the undivided profits. The remedy for a failure to divide the profits when they ought to be divided must be obtained through the corporate organization.¹

§ 236. The right of a shareholder to obtain from the agents of the company a certificate showing the number of shares held by him, and the extent to which they have been paid up, is an individual right; and so also is the right of a shareholder to transfer his shares to another person. These rights may be protected and enforced by each shareholder separately, either through an action for damages or a proceeding for specific relief.²

The right of a shareholder to be present and vote at meetings,³ and the right to inspect the books of the company where that right exists,⁴ are of a similar character. They are rights belonging to each shareholder severally, and may be enforced by a proceeding of mandamus, or a bill in equity for specific relief, or by an action for damages, as the case may be.

§ 236 *a*. A shareholder cannot sue individually for damages caused by wrongful acts impairing the value of his shares through an invasion of the corporate or collective rights; under these circumstances, the remedy must be obtained by the corporation or through the corporation.⁵ On the other hand, if the individual rights of a shareholder are impaired by any person, whether he be a shareholder or not, the remedy

¹ *Infra*, §§ 276-278. *Jackson v. Newark Plank Road Co.*, 31 N. J. Law, 277, 280.

² *Supra*, § 212 *et seq.* *Infra*, § 453. For a further instance of such a right see *O'Connor v. North Truckee Ditch Co.*, 17 Nev. 245.

³ *Infra*, § 463.

⁴ See *infra*, § 454. The right to inspect the transfer-books is often provided by statute, and guarded by statutory penalties.

⁵ *Infra*, §§ 291, 545. In *Bal-*

timore, &c. R. R. Co. v. Fifth Baptist Church, 108 U. S. 317, it was held that a religious corporation owning a church was entitled to relief against a railroad company for causing its members discomfort and annoyance while at church, through noise, smoke, and cinders. The cause of complaint was a corporate one, because the nuisance rendered the church property less valuable for the uses to which it was devoted.

must be obtained by the shareholder suing individually, and the corporation cannot sue on his behalf.¹

§ 237. **The Collective Rights of Shareholders.**—In determining whether individual shareholders can sue for the protection of their *collective* interests in the company, it is necessary to consider, firstly, the exact nature of the rights of the shareholders, and, secondly, the rules of procedure which have been established by law for reasons of convenience or necessity.

The relation between a corporation and its several members may, for practical purposes, be treated as that of trustee and *cestui que trust*. In contemplation of law, the property and rights of an incorporated association belong to the corporation as an entity, and not to the shareholders. The latter, however, are the real parties in interest, each shareholder having an interest which may be defined, in general terms, as a right to have the corporate property and affairs managed in accordance with the charter and articles of agreement; and this right will be protected and enforced by the courts of equity, by treating the corporate entity as their trustee. The nature of the trust is declared in the charter, to which the stockholders have unanimously agreed: "As the shareholders are in substance partners in a trading corporation, the management of which is intrusted to the body corporate, a trust is by implication created in favor of the shareholders, that the corporation will manage the corporate affairs and apply the corporate funds for the purpose of carrying out the original speculation."²

¹ *Infra*, §§ 545–547. A corporation cannot restrain the levy of an unlawful tax upon the shares held by its shareholders individually. *Waseca County Bank v. McKenna*, 32 Minn. 468.

² *Per* Blackburn, J., in *Taylor v. Chichester, &c. Ry. Co.*, L. R. 2 Exch. 378.

In *Stevens v. Rutland, &c. R. R. Co.*, 29 Vt. 549, 550, Chancellor

Bennett said: "The plaintiff, by his subscription, assumed to pay to the corporation, and only for the purposes specified in the charter, its amount, according to the assessments; and there was at the same time a TRUST created, and an implied assumption on the part of the corporation to apply it to that object and no other." See also *Russell v. Wakefield W. W. Co.*, L. R. 20 Eq.

§ 238. **When a Shareholder may sue. — General Rule.** — The right of a shareholder to bring a suit on account of anything affecting his interest in the property or affairs of the corporation depends to a great extent upon the peculiar character of the corporate organization. The entire management of the affairs of a corporation is delegated by its shareholders to the care of the corporate agents. These agents are of various classes, and differ both in the duties which they have to perform and the powers with which they are intrusted. Within the scope of the charter, the majority is supreme; and ordinarily the active management of the corporate affairs is delegated to a president and directors, who have authority to appoint other inferior agents.¹

Only the regular officers and agents whose appointment was provided for, expressly or impliedly, by the charter or articles of association of a corporation, have authority to act for it; the individual shareholders, as such, have no power either to represent the body corporate, or to bring suit in its behalf, or to interfere in any way with its management.² It is only by consent of all the shareholders that any agent can derive his authority to represent the whole body corporate. It follows, therefore, that a corporation can obtain redress for a wrong committed against it only through the action of its regular officers; and if these are either unwilling or unable to act, the corporation as an entity has no means of obtaining a remedy. Under these circumstances it becomes necessary to take cognizance of the equitable inter-

479, *per* Jessel, M. R.; *Thompson v. Page*, 1 Metc. (Mass.) 570, *per* Shaw, C. J.; *Peabody v. Flint*, 6 Allen, 56, *per* Chapman, J.; *Sawyer v. Hoag*, 17 Wall. 623, *per* Justice Miller; *Taylor v. Miami Exporting Co.*, 5 Ohio, 162, *per* Wright, J.; *Dodge v. Woolsey*, 18 How. 331; *Hardy v. Metropolitan Land, &c. Co.*, L. R. 7 Ch. 427; *Kean v. Johnson*, 9 N. J. Eq. 407; *State v. Bank of Louisiana*, 6 La. 745, 759. See *infra*, § 1012.

¹ *Infra*, §§ 454, 483.

² *Bronson v. La Crosse R. R. Co.*, 2 Wall. 301; *Peabody v. Flint*, 6 Allen, 55, 56; *Forbes v. Memphis, &c. R. R. Co.*, 2 Woods, 331; *Allen v. Curtis*, 26 Conn. 461; *Blackman v. Central R. R., &c. Co.*, 58 Ga. 189; *Silk Manuf. Co. v. Campbell*, 3 Dutcher, 539; *Union Agricultural Society v. Gamble*, 52 Iowa, 524; *Henry v. Elder*, 63 Ga. 347; *Park v. Petroleum Co.*, 25 W. Va. 108.

ests of the individual shareholders, and to allow them to sue for the protection of their rights.¹

§ 239. **A Shareholder cannot sue if the Corporation is able to protect itself.** — It is a general rule, founded on convenience and the implied agreement of the parties, that where a trustee is invested with active duties and represents numerous beneficiaries, no portion of these beneficiaries are entitled to bring a suit for the protection of the trust, unless the trustee has refused, or is unable, to take the necessary steps to protect it on their behalf.²

This rule applies with peculiar force to the trust deemed to exist between a corporation and its individual shareholders. It is obvious that it would be exceedingly inconvenient if the numerous shareholders in a corporation were allowed to proceed in equity for relief, on account of every injury to the corporate rights or property. Redress could be obtained far more conveniently, and with less expense, by a suit brought in the name of the corporation as an entity on behalf of all the shareholders. And in those cases in which the courts of law provide an adequate remedy for a wrong against the corporation, the propriety of seeking redress in the name of the corporation and by means of the legal remedy becomes still further apparent. Moreover, it is part of the agreement between the shareholders of a corporation, that the entire management of the corporate affairs shall be intrusted to certain specified

¹ It has been held that, if a receiver appointed by the Comptroller of the Currency to take charge of the assets of a national bank refuses to bring suit against the directors of the bank to recover assets which have been misapplied or lost by misconduct of the directors, a shareholder may bring the suit, by making the corporation and the receiver parties, together with the directors against whom relief is sought. *Brinkerhoff v. Bostwick*, 88 N. Y. 52; s. c. 23 Hun, 237; 99 N. Y. 185.

² *Western R. R. Co. v. Nolan*, 48 N. Y. 513; *Weetjen v. Vibbard*, 5 Hun, 265; *Skiddy v. Atlantic, &c. R. R. Co.*, 3 Hughes, 350; *Alexander v. Central R. R. Co.*, 3 Dill. 487; *Knapp v. Railroad Co.*, 20 Wall. 117; *Sturges v. Knapp*, 31 Vt. 55, 58; *Shaw v. Norfolk County R. R. Co.*, 5 Gray, 162; *Coe v. Columbus, &c. R. R. Co.*, 10 Ohio St. 410; *New Jersey Franklinite Co. v. Ames*, 1 Beas. 511; *Williamson v. New Jersey, &c. R. R. Co.*, 10 C. E. Green, 13; *Robinson v. Smith*, 3 Paige, 225, and cases cited.

agents; and this includes a delegation of the power of protecting the company from injuries, and enforcing its collective rights. Each shareholder must be held to have agreed that all proceedings for the protection of the corporate property and rights shall be brought by the corporation as an entity, acting through its regular agents. It may therefore be stated as a rule, that redress for a wrong against a corporation should be obtained by the corporation itself, through its regularly appointed agents; and it is only in case the corporation has been dissolved or disabled from proceeding on its own behalf, by reason of the misconduct or disability of its agents, that the shareholders may themselves proceed in chancery for the protection of their equitable rights.¹

§ 240. It must appear that no Agent of the Corporation is willing and able to act.—In order to maintain a suit for the protection of his equitable rights in the corporation, a shareholder must allege and prove that no agent of the company having the requisite authority is willing and able to act on its behalf. Ordinarily, the directors of a corporation have complete power to control its action, and to decide whether it shall enter into a litigation or not. In such case, therefore, a shareholder cannot obtain the interposition of the courts without showing that the directors are either unwilling or unable to bring suit on behalf of the corporation.² And even where the directors or ordinary managing officers of a corporation are at fault, it does not necessarily follow that the corporation is disabled from procuring justice for itself. For the majority of shareholders in corporate meeting have supreme authority under the charter to manage the corporate affairs;

¹ In *Russell v. Wakefield W. W. Co.*, L. R. 20 Eq. 479, Sir G. Jessel, M. R., said: "I entirely agree that the general rule, if I may say so respectfully, is correctly stated by Lord Justice James in *Gray v. Lewis*: 'Where there is a corporate body capable of filing a bill for itself to recover property either from its directors or officers, or from any other person, that corporate body is the

proper plaintiff, and the only proper plaintiff.' " *Gray v. Lewis*, L. R. 8 Ch. 1035; *Hersey v. Veazie*, 24 Me. 9; *Robinson v. Smith*, 3 Paige, 233; *Allen v. New Jersey, &c. R. R. Co.*, 49 How. Pr. 14; *Lafond v. Deems*, 81 N. Y. 507.

² *Hersey v. Veazie*, 24 Me. 9; *Cogswell v. Bull*, 39 Cal. 324; *McMurray v. Northern Ry. Co.*, 22 Grant (U. C.), Ch. 476.

and whenever it is possible to obtain justice by calling a meeting of the shareholders, and removing the offending officers and electing new ones, this remedy must be pursued. In such case, a shareholder cannot obtain relief in equity, since the ground for relief fails; namely, that the corporation, his trustee, is unable to protect the trust.¹

§ 241. **When a Demand is necessary.** — If the governing agents of a corporation are *able* to act on its behalf, a shareholder cannot sue without showing that they are *unwilling* to act; and it is but reasonable to require that a shareholder should make a request upon the proper agents to act for the corporation, where he bases his claim for relief upon their failure. A shareholder asking the courts to interfere with the management of the corporation, or to grant relief on account of an infringement of its rights, must therefore usually show that the directors or managing officers having control of the corporation have refused to act on its behalf.²

¹ *Bill v. Western Union Tel. Co.*, 16 Fed. Rep. 14; *Hersey v. Veazie*, 24 Me. 11; *Foss v. Harbottle*, 2 Hare, 495; *Re London, &c. Discount Co.*, L. R. 1 Eq. 277.

In *Hawes v. Oakland*, 104 U. S. 450, 460, Mr. Justice Miller stated the rule as follows: "The plaintiff should show to the satisfaction of the court that he has exhausted all the means within his reach to obtain, within the corporation itself, the redress of his grievances, or action in conformity to his wishes. He must make an earnest, not a simulated effort, with the managing body of the corporation, to induce remedial action on their part, and this must be made apparent to the court. If time permits, or has permitted, he must show, if he fails with the directors, that he has made an honest effort to obtain action by the stockholders as a body in the matter of which he complains. And he must show a case, if this is not

done, where it could not be done, or it was not reasonable to require it."

² "This refusal of the board of directors is essential in order to give the stockholder any standing in court, as the charter confers upon the directors representing the body of stockholders the general management of the business of the company. There must be a clear default, therefore, on their part, involving a breach of duty, within the rule established in equity, to authorize a stockholder to institute a suit in his own behalf, or for himself and other stockholders who may choose to join." *Memphis City v. Dean*, 8 Wall. 73.

To the same effect, see *Hawes v. Oakland*, 104 U. S. 450; *Morgan v. Railroad Co.*, 1 Woods, 15; *Samuel v. Holladay*, 1 Woolw. 414; *Newby v. Oregon, &c. Ry. Co.*, 1 Sawyer, 63; *Wilkie v. Rochester, &c. Ry. Co.*, 12 Hun, 242; *Greaves v. Gouge*, 69 N. Y. 154; *Black v.*

§ 242. **When a Demand is not necessary.** — But a demand upon the proper agents, and their refusal to act, are material only because they show that the corporation itself is unable to protect the rights of its members; for a corporation has no means of acting except by its agents. And therefore, if any sufficient reason is shown why the corporation cannot safely be left to obtain relief through the action of its agents, a court of equity will interfere, at the suit of a shareholder, without proof of a demand upon the managing agents and their wrongful refusal or neglect to proceed on behalf of the company.

Thus, if the agents of a corporation in whom the authority to direct its litigation is vested, are themselves guilty of a wrong against the corporation, a court of equity will interfere at the suit of a shareholder to protect his interest in the corporation, without requiring him first to request the guilty agents to proceed in the name of the corporation against themselves. For a demand would ordinarily be nugatory under these circumstances; and it would be wholly contrary to established principles of justice to permit the authors of a wrong to conduct a litigation against themselves as agents of the injured complainant.¹

It is evident that a demand is not necessary before bringing suit, if it is impossible to make a demand; as where the directors have all resigned, or cannot be found.²

Huggins, 2 Tenn. Ch. 780; Ware v. Bazemore, 58 Ga. 316; Talbot v. Scripps, 31 Mich. 268; Lothrop v. Stedman, 42 Conn. 583.

It must be shown that a majority of the directors holding office at the time of bringing suit are unwilling or unable to act, where the wrong was committed by a prior board of directors. Cogswell v. Bull, 39 Cal. 320.

As to the time of raising the objection that the petition of a shareholder does not show a previous demand upon the directors, see Bulkley v. Big Muddy Iron Co., 77 Mo. 105.

¹ Peabody v. Flint, 6 Allen,

52; Brewer v. Boston Theatre Co., 104 Mass. 378, 387; Mussina v. Goldthwaite, 34 Tex. 125; Pond v. Vermont Valley R. R. Co., 12 Blatchf. 280; Hardon v. Newton, 14 Blatchf. 376; Hazard v. Durant, 11 R. I. 195; Salomons v. Laing, 12 Beav. 377; Heath v. Erie Ry. Co., 8 Blatchf. 410; Robinson v. Smith, 3 Paige, 222; Currier v. New York, &c. R. R. Co., 35 Hun, 355; Rogers v. Lafayette Agricultural Works, 52 Ind. 296; Deaderick v. Wilson, 8 Baxter (Tenn.), 108; Moore v. Schoppert, 22 W. Va. 282, 290.

² Wilcox v. Bickel, 11 Neb. 154.

§ 243. **The Discretionary Powers of the Company's Agents cannot be impaired.**—The managing agents of ordinary private corporations are invested with wide discretionary powers; if this were not so, it would be impossible to carry on the business of such companies successfully.

So long as the agents of a corporation act honestly within the powers conferred upon them by the charter, they cannot be controlled. The individual shareholders have no authority to dictate to the company's agents what policy they shall pursue, or to impair that discretion which was conferred upon them by the charter. If shareholders are dissatisfied with the agents, whom they have elected, their remedy is to elect other agents, in the manner and at the time provided by the charter. It would be a violation of the charter contract, and a wrong to every dissenting member, to permit any portion of the shareholders to interfere with the discretionary powers which were intrusted to the agents of the corporation alone.

It may therefore be stated as a rule, that no shareholder can interfere with the management of the corporation, or complain of a wrong, so long as its regular authorities are acting honestly within the discretionary powers which have been intrusted to them.¹

¹ No shareholder can complain of the acts of the majority within the powers allotted to them. "Each and every stockholder contracts that the will of the majority shall govern in all matters coming within the limits of the act of incorporation; and in cases involving no breach of trust, but only error or mistake of judgment on the part of the directors who represent the company, individual stockholders have no right to appeal to the courts to decide the line of policy to be pursued by the corporation." *Dudley v. Kentucky High School*, 9 Bush, 578. See also *Lord v. Copper Miners' Co.*, 2 Phill. 751; *Treadwell v. Salisbury Manuf. Co.*, 7 Gray, 393;

Durfee v. Old Colony, &c. R. R. Co., 5 Allen, 231; *Fareira v. Riter*, 15 Phila. 58; *Sprague v. Illinois River R. R. Co.*, 19 Ill. 174; *East Tennessee, &c. R. R. Co. v. Gammon*, 5 Sneed, 567; *Bailey v. Power Street, &c. Church*, 6 R. I. 491; *People v. Chicago Board of Trade*, 80 Ill. 134; and compare *State v. Milwaukee Chamber of Commerce*, 47 Wis. 670; *Becher v. Wells Flouring Mill Co.*, 1 McCrary, 62.

Nor can the board of directors or other agents be controlled in the exercise of the discretionary powers conferred upon them. *Oglesby v. Attrill*, 105 U. S. 605; *Sims v. Street Railroad Co.*, 37 Ohio St. 557; *Elkins v. Camden, &c. R. R. Co.*,

§ 244. **Discretion as to Propriety of Suing.**—It is often a matter involving the exercise of much judgment, whether or not it be expedient, in a given case, to begin a litigation on account of an actionable injury. It is not the duty of the managing agents of a corporation to go to law immediately, whenever a wrong has been done to the corporation. The advisability of suing for redress, and the time and manner of proceeding, are largely intrusted to their judgment; and it is their duty to give the corporation the benefit of their best judgment in this respect. The refusal of the agents of a corporation to institute legal proceedings on its behalf, even when requested by its shareholders, may possibly be a judicious exercise of the discretion which was conferred upon them by the charter. This discretionary power confided to the agents of a corporation cannot be usurped by its shareholders; and therefore the courts will not interfere at the suit of a shareholder to redress an injury suffered by the corporation, merely because its managing agents have in good faith refused to begin a suit in the name of the corporation.¹

36 N. J. Eq. 241; *Tuscaloosa Manuf. Co. v. Cox*, 68 Ala. 71; *Hedges v. Paquett*, 3 Oreg. 77; *State v. Bank of Louisiana*, 6 La. 745, 763; *Gravenstine's Appeal*, 49 Pa. St. 310; *Dudley v. Kentucky High School*, 9 Bush, 578; *Banet v. Alton, &c. R. R. Co.*, 13 Ill. 504; *Karnes v. Rochester, &c. R. R. Co.*, 4 Abb. Pr. N. S. 110; *Pratt v. Pratt*, 33 Conn. 446; *Smith v. Prattville Manuf. Co.*, 29 Ala. 503.

¹ In *Samuel v. Holladay*, 1 Woolw. (U. S. C. Ct.) 400, Justice Miller said: "It would be a doctrine attended with very serious consequences if every individual shareholder, assuming the place of the corporation, could decide for it when action should be brought to vindicate its supposed right. Each one of the shareholders might elect to claim a remedy, and resort to a tribunal different from those chosen

by every other, and use the court of equity to enforce his views, regardless of its duly constituted officers and all other parties having interests, rights, and powers equal to his own. In such a struggle the real interests of the corporation might be entirely sacrificed. If such a doctrine should obtain, it would be dangerous to deal with a corporation, for, whatever the understanding had with its lawful representatives, no one could be protected from the individual shareholders. If a stockholder is aggrieved by the refusal of the board of directors to accept his views, his remedy is to unite with other stockholders and change those directors. But if irreparable mischief to his interests may ensue in the mean time, equity will administer preventive justice until such time as the will of the body of stockholders can be ascer-

§ 245. **A Shareholder may sue where the Directors have committed a Breach of Duty.** — A different case is presented where the managing agents of a corporation are themselves the authors of a wrong, or where their refusal to bring suit in the name of the corporation is in excess of their discretionary powers. Here there is an injury to the corporate trust which should be redressed, and the corporation itself is unable to seek redress by reason of the default of its agents. Under these circumstances a shareholder can base his claim to the assistance of the courts of equity upon the common ground of equity jurisdiction; namely, that the complainant's equitable rights have been infringed, and that no other remedy is available.

Yet, even in this case, there are two considerations which may limit the right of a shareholder to obtain relief, as will be shown in the following sections.

§ 246. **Exception 1. Where the Majority may ratify the Unauthorized Act.** — The managing agents of a corporation are generally inferior, in authority, to the majority at a shareholders' meeting. Hence an act of the managing agents may be in excess of their powers, and consequently a wrong to the corporation, and yet may be within the powers of the majority; and the majority may have power to ratify the act on behalf of the corporation.¹ It would obviously be improper, under these circumstances, to interfere at the suit of a shareholder. For the majority, acting, within the powers conferred upon them, on behalf of the whole association, might afterwards ratify the unauthorized act, and thus destroy all claim for relief.

§ 247. **Foss v. Harbottle.** — The leading authority upon this point is *Foss v. Harbottle*,² decided by Vice-Chancellor Wigram in 1843. It was alleged by the complainants, that the defendants, who were directors of the corporation, had

tained." *Re London, &c. Discount* 637; *Abbott v. Merriam*, 8 Cush. Co., L. R. 1 Eq. 277; *McMurray v.* 588; *Dodge v. Woolsey*, 18 How. Northern Ry. Co., 22 Grant (U. C.), 344, 345. *Infra*, § 248.
Ch. 503; *Newby v. Oregon Central* ¹ *Infra*, § 606.
Ry. Co., 1 Sawy. 63. Compare ² 2 Hare, 461.
Belmont v. Erie Ry. Co., 52 Barb.

purchased their own lands of themselves for the use of the company, and had paid for them, or rather taken to themselves out of the funds of the company, a price exceeding the value of the lands. The learned judge held that the transaction was unauthorized, and might be set aside by the company, but that the majority at a meeting of the shareholders might ratify it on behalf of the corporation, and that therefore the court would not interfere. "Whilst the court may be declaring the acts complained of to be void at the suit of the present plaintiffs, who in fact may be the only proprietors who disapprove of them, the governing body of proprietors may defeat the decree, by lawfully resolving upon the confirmation of the very acts which are the subject of the suit. The very fact that the governing body of proprietors, assembled at the special general meeting, may so bind even a reluctant minority, is decisive to show that the frame of this suit cannot be sustained whilst that body retains its functions. In order, then, that this suit may be sustained, it must be shown, either that there is no such power as I have supposed remaining in the proprietors, or, at least, that all means have been resorted to and found ineffectual to set that body in motion."¹

§ 248. **When the Majority have a Discretionary Power to determine the Propriety of bringing Suit.**—Even in those cases where a clearly actionable wrong has been committed against the corporation, the majority as well as the board of directors are invested to a certain extent with authority to use their discretion in deciding whether or not it would be judicious to prosecute a suit on behalf of the company, and at its expense. Under these circumstances, it would clearly be improper to infringe upon this power at the suit of any of the shareholders.

Thus, in *Re Mercantile Discount Co.*,² Vice-Chancellor Page-Wood declined to interfere at the suit of a minority of

¹ *Foss v. Harbottle*, 2 Hare, 493, *MacDougall v. Gardiner*, L. R. 1 494; *Lord v. Copper Miners' Co.*, Ch. D. 13.

² *Phill.* 751; *Wallace v. Long* ² *Re London, &c. Discount Co.*, *Island R. R. Co.*, 12 Hun, 460; L. R. 1 Eq. 277, 283; *MacDougall*

the shareholders of a company, upon the ground that the advisability of proceeding to a litigation on account of the alleged wrongs to the company was a matter which the majority had discretionary power to decide, and it had not been shown that the majority had abused their powers.

§ 249. **When the Rule in *Foss v. Harbottle* does not apply.—**When the Majority cannot ratify.—The principle acted upon in the case of *Foss v. Harbottle* has no application where the act complained of is wholly unauthorized by the charter of the corporation, and therefore in excess of the powers of the majority. In such case the act cannot be ratified without the unanimous consent of the shareholders.¹

In *Bagshaw v. Eastern Union Ry. Co.*,² the same judge who decided the case of *Foss v. Harbottle* said: "I think the plaintiff in this case has shown that the directors have misapplied, and are about to misapply, the £100,000 I have adverted to; that is, the £100,000 raised under the Hadleigh act. No majority of the shareholders, however large, could sanction the misapplication of this portion of the capital. A single dissenting vote would frustrate the wishes of the majority. Indeed, in strictness, even unanimity would not make the act lawful. This appears to take it out of the case of *Foss v. Harbottle*, to which I was referred."³

§ 250. **When a preventive Remedy is asked against the Company's Agents.**—It is to be observed that the rule in *Foss v. Harbottle* has no application in those cases where merely a

v. Gardiner, L. R. 1 Ch. D. 13; and see *supra*, § 244. Compare *Gregory v. Patchett*, 33 Beav. 606.

¹ *Infra*, § 602.

² 7 Hare, 129.

³ Referring to *Foss v. Harbottle*, the learned Vice-Chancellor said: "That case does not, I apprehend, upon this point go further than this: that if the act, though it be the act of the directors only, be one which a general meeting of the company could sanction, a bill by some shareholders on behalf of themselves and

others to impeach that act cannot be sustained, because a general meeting of the company might immediately confirm and give validity to the act of which the bill complains." *Bagshaw v. Eastern Union Ry. Co.*, 7 Hare, 130. See also *Atwood v. Merryweather*, L. R. 5 Eq. 464 n., 468; *Salomons v. Laing*, 12 Beav. 377; *Heath v. Erie Ry. Co.*, 8 Blatchf. 406; *Hoole v. Great Western Ry. Co.*, L. R. 3 Ch. 274; *Hazard v. Durant*, 11 R. I. 207; *Brewer v. Boston Theatre Co.*, 104 Mass. 394-397.

preventive remedy against the commission of unauthorized acts is asked.¹ The only reason for refusing affirmative relief is that the action of the court might be nullified by the subsequent vote of the majority. But every shareholder has a right to insist that the agents of the company shall not exceed the authority delegated to them, and that the wishes of the majority, upon matters resting in the discretion of the majority alone, shall be consulted, in the proper manner and at the proper time. To refuse to restrain the agents of a corporation from doing acts in excess of their authority merely because the majority might authorize these acts if they chose to do so, would deprive the shareholders of an important privilege, and practically leave them at the mercy of their agents.

§ 251. **Exception 2. Where Delay until the Directors can be removed is advisable.** — *Mozley v. Alston*. — Wrongs against a corporation can best be redressed by the corporation itself, through its duly elected agents. The convenient administration of justice, and the ultimate interests of all parties, require that the right of shareholders to sue for the protection of their collective interests in the corporate affairs be restricted within the smallest possible limits. If one shareholder is accorded such a right, every other shareholder in the company may claim the same privilege. A large number of suits might thus be brought by the various shareholders, each in his own behalf, thereby entailing heavy expense upon the corporation and the parties against whom the relief was sought.²

It is frequently in the power of the corporation, through a majority vote of the shareholders, to remove the directors or managing agents who have failed in their duty. Under these circumstances, a delay of redress until the corporation can itself take action through the agency of the majority is often advisable; and the courts will not interfere at the suit of a

¹ *Railway Co. v. Allerton*, 18 Wall. 233; *Exeter, &c. Ry. Co. v. Buller*, 5 Eng. Ry. Cas. 211; *Re London, &c. Discount Co.*, L. R. 1 Eq. 277. ² See *per James, L. J.*, in *Gray v. Lewis*, L. R. 8 Ch. 1050, 1051.

shareholder, even though the managing agents be derelict in their duty, unless it appear that a delay of the remedy until a corporate meeting can be held, and the guilty agents be removed, would unduly prejudice the rights of the complainants. The leading case upon this point is *Mozley v. Alston*, decided by Lord Chancellor Cottenham.¹

§ 252. **No Delay required where it would be useless.** — The rule stated in the preceding section applies in all cases where an actionable wrong has been committed against a corporation. And it must be assumed for this purpose that the corporation would be *able* to obtain relief through the agency of the majority, if a short delay were had. However, if the majority are either unwilling or unable to move on behalf of the company, there can be no reason for waiting until a meeting of the shareholders can be convened; under these circumstances, the courts will grant relief at the suit of a shareholder.²

Thus, if the wrongful acts of the majority constitute the cause of complaint, or if it can be shown that the majority have co-operated with the wrong-doers, or have prevented suit from being brought in the name of the corporation, or if the wrong-doers have obtained control of a majority of shares in the corporation, or if it is impossible for any cause to have a fair meeting, — in all these cases the courts will interfere at the suit of a shareholder, and grant whatever relief may be necessary to do complete justice.³

¹ *Mozley v. Alston*, 1 Phill. 800; Eq. 464 *n.*, 468; *Russell v. Wakefield* *Gray v. Lewis*, L. R. 8 Ch. 1050; *W. W. Co.*, L. R. 20 Eq. 482; *Cannon v. Trask*, L. R. 20 Eq. 669; *Menier v. Hooper's Telegraph Works*, L. R. 9 Ch. 350; *Davidson v. Grange*, 4 Grant (U. C.) Ch. 377; *Brewer v. Boston Theatre Co.*, 104 Mass. 378; *Neall v. Hill*, 16 Cal. 151; *Wright v. Oroville Mining Co.*, 40 Cal. 20; *Taylor v. Miami Exp. Co.*, 5 Ohio, 162; *Sears v. Hotchkiss*, 25 Conn. 171; *Peabody v. Flint*, 6 Allen, 54; *Hazard v. Durant*, 11 R. I. 195; *Beman v. Rufford*, 1 Sim. n. s. 550; *Rogers v. Lafayette Agr. Works*

² See *supra*, § 242.

³ *Atwool v. Merryweather*, L. R. 5

§ 253. **No Delay where Justice requires immediate Relief.** — The general rule is, that the courts will in all cases provide the shareholders of a corporation with an adequate remedy for the protection of their equitable rights. In applying this rule it must be borne in mind that the primary and best means of obtaining redress is in a suit brought by the corporation through its agents, and the courts will not interfere if a short delay would enable the corporation to act for itself, provided no irreparable injury be threatened in the mean time. If, however, it appears that a delay of action until a meeting of the shareholders can be convened may be productive of injustice, the courts will not hesitate to grant whatever relief may be needed at the suit of the individual shareholders. Thus there can be no doubt that the courts would decree an accounting, or order property which has been wrongfully taken away from a corporation to be restored, if a delay of this redress until a meeting could be held might unduly prejudice the rights of the company, either through insolvency of the wrong-doers, or through any other cause.

The courts will also grant immediate relief where the managing agents of a corporation wrongfully refuse to defend suits brought against the corporation. In such case, a delay until a meeting of the stockholders can be held would generally be fatal, by subjecting the corporation to a judgment by default.¹

§ 254. **No Delay in granting preventive Remedies.** — A corporation, like an individual, can obtain an injunction for the protection of its rights only upon showing that an injury is threatened for which other remedies would not provide adequate redress. It would seem to follow, therefore, that whenever a corporation is entitled to an injunction to protect itself, and is not able to apply for the remedy, a shareholder may obtain relief for the protection of his own interests; whatever would be an irreparable injury to a corporation would neces-

Co., 52 Ind. 297. Compare *Foss v. Harbottle*, 2 Hare, 495; *MacDougall v. Gardiner*, L. R. 20 Eq. 383; 1 Ch. D. 13.

¹ See *Bronson v. La Crosse R. R. Co.*, 2 Wall. 302; *Dodge v. Woolsey*, 18 How. 331; *City of Wheeling v. Mayor*, 1 Hughes, 90, 95.

sarily also be an irreparable injury to the shareholders who compose it.¹

§ 255. **A Court of Equity will fully dispose of a Case properly before it.** — Another rule which must be considered in connection with this subject is the rule that a court of equity will, under ordinary circumstances, fully dispose of a case which is properly before it. If, therefore, shareholders are entitled to an injunction for the protection of their rights from future infringements, and all the necessary parties are before the court, complete relief will usually be granted in the same suit on account of past wrongs which form part of the same cause of action. In *Russell v. Wakefield Water Works Co.*,² Sir George Jessel, M. R., said: "When you have got the second corporation or person a party to the suit, it may happen that, in addition to the relief that you are entitled to as regards the first, you are entitled to have relief against the second for something that has been done under the *ultra vires* agreement. You may be entitled to have money paid back which has been paid under the *ultra vires* agreement, as in the case of *Salomons v. Laing*,³ and you may be entitled to have property returned, or other acts done. If the detainer or holder of the money or property, that is, the second corporation or other person, is already a party, and a necessary party, to the suit, it would be indeed a lame and halting conclusion if the court were to say it could [not] do justice in a suit so framed by ordering the money to be returned or the property restored. It is a necessary incident to the first part of the relief which can be obtained by individual corporators, and will do complete justice on each side, and that has always been the practice of the court. Therefore, in a case so framed, there is no objection to a suit by an individual corporator to recover from another corporator, or from any other persons being strangers to this corporation,

¹ See *Bloxam v. Metropolitan Ry. Co.*, L. R. 3 Ch. 337; *Dodge v. Woolsey*, 18 How. 331; *Fraser v. Whalley*, 2 H. & M. 10; *Manderson v. Commercial Bank*, 28 Pa. St. 379; *Pickering v. Stephenson*, L. R. 14

Eq. 322; *Lyde v. Eastern Bengal Ry. Co.*, 36 Beav. 10; *Leo v. Union Pacific Ry. Co.*, 17 Fed. R. 273.

² L. R. 20 Eq. 474, 481.

³ 12 Beav. 377.

the money or property so improperly obtained. But that is not the only case. Any other case in which the claims of justice require it is within the exception."¹

§ 256. **Parties to a Shareholder's Bill. — Complainants.** — Any holder of a single share may bring suit to protect his interest in the corporation.² All the shareholders may properly join as complainants, but this is not necessary.³ If a portion only of the shareholders are complainants, the suit should purport to be brought by the plaintiffs in behalf of themselves and all other shareholders similarly interested.⁴ But this is merely a technical rule of practice; the suit must, by reason of the character of the relief prayed, be for the benefit of the corporation, or all the shareholders, whether it purport to be for their benefit or not. In some cases, the allegation that the suit was brought by the plaintiff on behalf of all others similarly interested has therefore been dispensed with.⁵

If any of the shareholders are parties to the wrong complained of, they may be made defendants.⁶

¹ *Russell v. Wakefield W. W. Co.*, L. R. 20 Eq. 474, 481; *Gregory v. Patchett*, 33 Beav. 607.

² *Seaton v. Grant*, L. R. 2 Ch. 462; *Beman v. Rufford*, 1 Sim. n. s. 564; *Zabriskie v. Cleveland, &c. R. R. Co.*, 23 How. 395; *Samuel v. Holladay*, 1 Woolw. 400; *Dodge v. Woolsey*, 18 How. 331, 341; *Kean v. Johnson*, 1 Stockt. 401; *Gifford v. N. J. R. R., &c. Co.*, 2 Stockt. 171, 174; *Elkins v. Camden, &c. R. R. Co.*, 36 N. J. Eq. 5, 14; *Rogers v. Lafayette Agr. Works*, 52 Ind. 304; *Armstrong v. Church Soc.*, 13 Grant (U. C.), 556.

³ See *Mozley v. Alston*, 1 Phill. 798; *Robinson v. Smith*, 3 Paige, 232; *Peabody v. Flint*, 6 Allen, 57; *Whitney v. Mayo*, 15 Ill. 251; *Rogers v. Lafayette Agr. Works*, 52 Ind. 297.

⁴ *Mozley v. Alston*, 1 Phill. 798; *Robinson v. Smith*, 3 Paige, 233; *White v. Carmarthen, &c. Ry. Co.*,

1 H. & M. 786; *Smith v. Swormstedt*, 16 How. 302; *Zabriskie v. Cleveland, &c. R. R. Co.*, 23 How. 395; *March v. Eastern R. R. Co.*, 40 N. H. 548; *Peabody v. Flint*, 6 Allen, 56; *Whitney v. Mayo*, 15 Ill. 251; *Clinch v. Financial Co.*, L. R. 4 Ch. 117. Compare *Edwards v. Shrewsbury, &c. Ry. Co.*, 2 De G. & Sm. 537; *Bailey v. Birkenhead, &c. Ry. Co.*, 12 Beav. 433.

⁵ See *Hooile v. Great Western Ry. Co.*, L. R. 3 Ch. 272; *Russell v. Wakefield W. W. Co.*, L. R. 20 Eq. 474, 481; *Simpson v. Westminster Hotel Co.*, 8 H. L. C. 712.

⁶ *Taylor v. Miami Exporting Co.*, 5 Ohio, 162; *Preston v. Grand Collier Dock Co.*, 11 Sim. 327; *Brewer v. Boston Theatre Co.*, 104 Mass. 378; *Burt v. British, &c. Ass.*, 4 De G. & J. 158. Compare *Bailey's Appeal*, 96 Pa. St. 253; *Becher v. Wells Flouring Mill Co.*, 1 McCrary, 62.

An equitable owner of shares may sue to protect his interest, though the legal title be in a trustee ;¹ but in such case the trustee is a necessary party.² And it seems clear, on principle, that a person to whom the corporation has agreed to issue shares may pursue the same remedy, provided he be entitled to enforce a specific performance of the contract.³ It should be observed, however, that the rights of an equitable owner or assignee of shares are in some respects different from those of a legal owner. An equitable owner of shares is not entitled to vote at meetings, or to receive a certificate, or enjoy any of the personal rights which belong only to shareholders on the books, until after a formal transfer has been executed.⁴

§ 257. **The Corporation must be made a Defendant.** — It is manifest that, in a suit brought by a shareholder to protect his equitable interest in the affairs of a corporation, the corporation is itself an indispensable party. The legal title to the corporate property and rights is vested in the corporation ; and each shareholder is beneficially interested only as member of the company. It would be impossible to work out the equities of the individual shareholders, except through the corporate organization.⁵

In *Davenport v. Dows*,⁶ Mr. Justice Davis said : “ The relief asked is on behalf of the corporation, not the individual shareholder, and, if it be granted, the complainant derives only an incidental benefit from it. It would be wrong, in case the shareholder were successful, to allow the corporation to renew the litigation in another suit involving precisely the same subject matter. To avoid such a result a court of equity will not take cognizance of a bill brought to settle a question in which the corporation is the essential party in interest, unless it is made a party to the litigation.”

¹ *Baldwin v. Canfield*, 26 Minn. 43. See *supra*, §§ 183, 216 *et seq.*

² *Great Western Ry. Co. v. Rushout*, 5 De G. & S. 290.

³ *Bagshaw v. Eastern Union Ry. Co.*, 7 Hare, 130; *Baldwin v. Canfield*, 26 Minn. 44. Compare, how-

ever, *Busey v. Hooper*, 35 Md. 15; *Walker v. Devereaux*, 4 Paige, 229; *Mills v. Northern Ry. Co.*, L. R. 5 Ch. 621.

⁴ See *supra*, §§ 169, 170.

⁵ See *supra*, §§ 227, 235.

⁶ *Davenport v. Dows*, 18 Wall.

However, if it is impossible to make the corporation a party to the proceeding, as where the corporate organization has ceased or a legal dissolution has taken place, a court of equity will appoint a receiver of the corporate estate, and, after making an adjustment of the rights of creditors and shareholders, will distribute the assets among those who are equitably entitled to receive them.¹

§ 258. **Other Defendants.**—All persons against whom relief is sought, or whose rights may be affected by the relief which is prayed, are necessary parties to the litigation. Thus, if a shareholder seeks to impeach the validity of a contract made by the agents of a corporation on its behalf, all parties to that contract must be made defendants.² And clearly it is necessary to make all parties defendants whom it is intended to charge with a misappropriation of corporate funds.

It has been held that the directors or managing agents of a corporation are not necessary parties to a suit for an injunction to restrain a misapplication of corporate funds, or the doing of any other unauthorized act in the name of the corporation. In such case, an injunction directed against the corporation on whose behalf the directors profess to act is binding upon them, as upon all others professing to act merely as agents on behalf of the company.³ But where an

626; *Samuel v. Holladay*, 1 Woolw. 414; *Cunningham v. Pell*, 5 Paige, 613; *Hersey v. Veazie*, 24 Me. 9; *Greaves v. Gouge*, 69 N. Y. 154; *Cicotte v. Anciaux*, 53 Mich. 228; *Charleston Ins., &c. Co. v. Sebring*, 5 Rich. Eq. 342; *Black v. Huggins*, 2 Tenn. Ch. 780; *Robinson v. Smith*, 3 Paige, 232. Compare *Smith v. Hurd*, 12 Metc. (Mass.) 371; *Wilkins v. Thorne*, 60 Md. 253; *Shawhan v. Zinn*, 79 Ky. 300.

In *Williston v. Michigan Southern, &c. R. R. Co.*, 13 Allen, 400, it was held that a shareholders' bill could not be maintained in a foreign State in which the company had no place of business and no officers. Under these circumstances, the court

would have no power to control the action of the company, and no means of enforcing obedience to its decree.

¹ *Infra*, § 1012. See *Ervin v. Oregon Ry. & Nav. Co.* 20 Fed. R. 577.

² *Hare v. London, &c. Ry. Co.*, 1 J. & H. 252.

³ *Winch v. Birkenhead, &c. Ry. Co.*, 5 De G. & Sm. 562; *Hatch v. Chicago, &c. R. R. Co.*, 6 Blatchf. 105; *Heath v. Erie Ry. Co.*, 8 Ib. 412; *People v. Sturtevant*, 9 N. Y. 263, affirming *Davis v. Mayor*, 1 Duer, 451, 484. Compare *Ferguson v. Wilson*, L. R. 2 Ch. 90, *per Lord Cairns*; *Clinch v. Financial Co.*, L. R. 4 Ch. 117; *Karnes v. Rochester, &c. R. R. Co.*, 4 Abb. Pr. n. s. 107.

injunction is asked in order to restrain the agents of a corporation from acting in their own behalf, and not merely as agents on behalf of the corporation, or where their individual rights or obligations, even though arising from their relation to the company, are involved, they are necessary parties, and should be made defendants.¹ The directors are certainly necessary defendants in all cases where relief is asked against them individually.

§ 259. **The Motive in bringing Suit is immaterial.** — If the rights of a corporation have been infringed, or are threatened with infringement, and the corporation is unable to apply to the courts for relief, a shareholder is entitled to sue for the protection of his equitable interest, whatever be his real motive in seeking redress; the motive of a plaintiff in bringing suit is immaterial.²

§ 260. **Plaintiff must have a real Interest.** — But the plaintiff must have a real interest. A suit instituted in the name of a shareholder who has merely the nominal ownership of shares, and who appears merely as a figure-head for the real owner, being indemnified by the latter against costs, is an imposition on the court, and cannot be maintained. Under these circumstances the courts decline to entertain the case, on account of the disqualification of the plaintiff, without regard to the rights of *bona fide* shareholders.³

This rule applies with peculiar force to those cases in which the real instigator of the suit is a rival company. A

¹ Compare *Heath v. Erie Ry. Co.*, 8 Blatchf. 411, 412; *Ferguson v. Wilson*, L. R. 2 Ch. 90; *Clinch v. Financial Co.*, L. R. 4 Ch. 117.

² *Colman v. Eastern Counties Ry. Co.*, 10 Beav. 1; *Forrest v. Manchester, &c. Ry. Co.*, 4 De G., F. & J. 131; *Central R. R. Co. v. Collins*, 40 Ga. 582; *Ramsey v. Gould*, 57 Barb. 398; *Occum Co. v. Sprague Manuf. Co.*, 34 Conn. 529; *Camden, &c. R. R. Co. v. Elkins*, 37 N. J. Eq. 273; *Pender v. Lushington*, L. R. 6 Ch. Div. 70.

³ *Robson v. Dodds*, L. R. 8 Eq. 301; *Forrest v. Manchester, &c. Ry. Co.*, 4 De G., F. & J. 126; *Ffooks v. South Western Ry. Co.*, 1 Sm. & G. 142; *Burt v. British, &c. Assur. Ass.*, 4 De G. & J. 158; *Filder v. London, &c. Ry. Co.*, 1 H. & M. 489; *Waterbury v. Merchants', &c. Express Co.*, 50 Barb. 168; *Belmont v. Erie Ry. Co.*, 52 Barb. 662; *Sparhawk v. Union Passenger Ry. Co.*, 54 Pa. St. 401.

corporation has no right to buy shares and enter upon a litigation, either in its own name, or indirectly through a person subservient to its interests, for the purpose of interfering with the management of a rival company, or restraining its operation; the agents of a corporation would have no authority to use its name or its funds for any such purpose.¹

There can be no doubt, however, that a suit brought by a trustee of shares, in good faith, for the protection of the interests of his *cestui que trust*, either at the request of the latter or in pursuance of the powers conferred by the trust, would be sustained. The objection to a proceeding by a plaintiff who has no interest, and is merely a puppet in the hands of another, is that such a suit is a fraud upon the court.

§ 261. **Plaintiff cannot sue if Corporation is barred by acquiescence.** — It is well settled that a corporation cannot repudiate an unauthorized engagement entered into by its directors, or other agents, after the shareholders have unanimously acquiesced in the transaction, and allowed the company to appropriate the resulting benefits.² Nor can a corporation maintain an action, either at law or in equity, on account of a violation of its rights or a misapplication of the corporate funds, after the acts complained of have been acquiesced in and condoned by the whole body of shareholders.³ If the corporation has no cause of action under these circumstances, it follows *a fortiori* that a shareholder cannot sue on its behalf.⁴

§ 262. **Individual Shareholders who have acquiesced are disqualified.** — The ratification of an unauthorized transaction by merely a portion of the shareholders would not bind the corporation, and would not bar a suit brought in its name for the protection and enforcement of the corporate rights. Even

¹ *Infra*, § 431.

² *Infra*, §§ 603-610.

³ *Infra*, § 605; *Hotel Co. v. Wade*, 97 U. S. 13.

⁴ *Scott v. De Peyster*, 1 Edw. Ch. 513, 536; *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159, 184-186; *Watts's Appeal*, 78 Pa. St. 370; § 271.

Terry v. Eagle Lock Co., 47 Conn. 141; *Kitchen v. St. Louis, &c. Ry. Co.*, 69 Mo. 224, 264; *Samuel v. Holladay*, 1 Woolw. 416; *Zabriskie v. Hackensack, &c. R. R. Co.*, 18 N. J. Eq. 178, 194; *Gray v. Chaplin*, 2 Russ. 126; and see *infra*,

although the majority were parties to the wrong complained of, or have executed a legal release to the wrong-doers, this would not preclude the corporation from maintaining a suit on account of the wrong; it would be the duty of the company's agents to proceed under these circumstances for the protection of the rights of the innocent minority.¹

The benefit of an action brought by a corporation necessarily results to all the shareholders equally, even where a portion of them were parties to the wrong, or have, by acquiescence, forfeited their equitable claims to redress. And this result is not, as a rule, unfair. The only possible method of working out the rights of the parties in a case of this kind is to preserve the fiction of a separate corporate entity, and to enforce the collective and the individual rights and obligations of the shareholders separately.

It is clear, therefore, that the acquiescence of a shareholder in a violation of the corporate rights, or even a participation in the wrong, would not deprive him of his interest in the cause of action belonging to the corporation as an entity. He would have a share in the benefits of a recovery, even although his personal liabilities should be thereby increased.

There is, however, evident propriety in refusing to allow a shareholder to sue on account of a wrong which he has voluntarily acquiesced in and condoned, even although the corporation might sue for his benefit. The plaintiff under these circumstances would have no meritorious cause of complaint, and he would be allowed to share in the benefits of a recovery by the corporation, merely because it would be impossible to separate his interest from the interests of the other shareholders. If the remaining shareholders should subsequently acquiesce in the transaction, the corporation itself would be bound, and the entire cause of complaint be barred. Individual shareholders who have acquiesced should at least be disqualified from suing where the other shareholders and the company through its agents have taken no steps to assert its rights.²

¹ *Supra*, § 249.

Co., 1 Sm. & G. 142, 164; *Burt v.*

² *Ffooks v. South Western Ry. British, &c. Assur. Ass.*, 4 De G.

§ 263. **Where preventive Relief is applied for.** — A shareholder who has acquiesced in an unauthorized act is not bound to submit to all future acts of a similar character.¹ Nor is a shareholder who has acquiesced in the making of an unauthorized and illegal contract necessarily precluded from applying to the courts to restrain its performance. If a contract made on behalf of a corporation is unauthorized and void, it is the duty of the agents of the company to refuse to perform it. To proceed and perform the void agreement would be a further wrong, and might result in a misapplication of the company's funds and a forfeiture of its franchises. Under these circumstances it may not be unfair to allow those shareholders who have acquiesced in the making of the unauthorized agreement to withdraw their assent, and apply for relief against the threatened violation of the company's charter. But the courts are entitled to exercise a wide discretion in cases of this description. They should certainly not allow a shareholder to change his mind, and apply for an injunction to restrain the performance of a contract to which he had previously consented, in any case in which this would be unfair to other persons.² Courts of equity have always exercised a discretionary power to refuse relief to a plaintiff who has acquiesced in the wrong complained of, or whose delay in asserting his rights would make it unfair to others to grant relief.

§ 264. **Where Plaintiff is disqualified, the Suit cannot proceed.** — If it appears in the progress of a suit that the complainant is personally disqualified from suing, the suit cannot proceed, though the other shareholders are entitled to relief. "As,

& J. 158; *Samuel v. Holladay*, 1 Woolw. 416; *Watts's Appeal*, 78 Pa. St. 370; *Peabody v. Flint*, 6 Allen, 57; *Thompson v. Lambert*, 44 Iowa, 239; *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159, 188; *Kitchen v. St. Louis, &c. Ry. Co.*, 69 Mo. 224, 264.

It is evident that shareholders who were parties or privies to a wrong cannot afterwards be heard

to complain. *Re Syracuse, &c. R. R. Co.*, 91 N. Y. 1; *Weed v. Little Falls, &c. R. R. Co.*, 31 Minn. 154.

¹ *Bloxam v. Metropolitan Ry. Co.*, L. R. 3 Ch. 337, 354. *Infra*, § 268.

² *Ffooks v. South Western Ry. Co.*, 1 Sm. & G. 142, 164; *Graham v. Birkenhead, &c. Ry. Co.*, 2 MacN. & G. 146; *Leo v. Union Pac. Ry. Co.*, 19 Fed. R. 283.

on the one hand, a plaintiff, who has a right to complain of an act done to a numerous society of which he is a member, is entitled effectually to sue on behalf of himself and all others similarly interested, though no other may wish to sue, so, although there are a hundred who wish to institute a suit and are entitled to sue, still if they sue by a plaintiff who has personally precluded himself from suing, that suit cannot proceed.”¹

§ 265. **A Transferee of Shares acquires the Rights of the former Holder.** — A shareholder who has acquired his shares after an unauthorized transaction has taken place certainly cannot base his complaint on the ground that he has suffered a wrong, or that his equitable rights have been infringed. Under these circumstances, the plaintiff's cause of action, if he have any, is derived by purchase and transfer from the former holder of the shares.

It has been pointed out that the estate of a corporation is to be treated as that of a continuing institution, irrespective of the members at any particular time composing it. Each share represents an interest in the entire concern, and the several holders are entitled to equal rights irrespective of the time when they acquired their shares. Causes of action belonging to the corporation increase the value of the corporate estate, and must be treated like any other assets; when enforced, they inure to the benefit of all the shareholders without distinction. It is plain, therefore, that a shareholder has an interest in all causes of action belonging to the corporation, whether they arose before or after he purchased his shares.² If the courts decline to protect this interest in any particular case, their refusal must be based upon some principle of public policy, or the personal disqualification of the plaintiff.

§ 266. **When a subsequent Transferee of Shares may sue.** — There seems to be no good reason why a shareholder should

¹ *Burt v. British, &c. Assur. Central R. R. Co. v. Collins*, 40 Ga. Ass., 4 De G. & J. 158, 174; *Bel-* 616.

mont v. Erie Ry. Co., 52 Barb. 663; ² *Ervin v. Oregon Ry., &c. Co.*, *Hubbell v. Warren*, 8 Allen, 173; 28 Hun, 269.

not, as a rule, be permitted to sue on account of causes of action which arose before he purchased his shares, it being assumed, of course, that the corporation ought to sue, but is unable to act. If purchasers were disqualified from protecting their interests under these circumstances, the transferable value of shares might be impaired, and the loss would fall upon the innocent holders who were wronged.

It is not material that the plaintiff knew of the wrongs complained of before purchasing the shares,¹ or that he purchased them with the intention of bringing suit in the interest of a rival company, and not for the benefit of his associates.² Courts cannot investigate the secret intentions of parties, or refuse to protect their apparent and substantial rights by reason of some ulterior improper design. The purpose with which a shareholder obtained his shares and began the litigation should merely be considered as a circumstance tending to discredit his case.

The general rule appears to be settled in accordance with these views,³ but there are certain qualifications which must not be overlooked.

§ 267. **Rights of a Transferee of a Shareholder who is disqualified from suing.**—A purchaser of shares acquires no greater rights than the prior holder. If a violation of the corporate rights is acquiesced in by all the shareholders, the cause of action becomes extinguished thereby, and no share-

¹ In *Seaton v. Grant*, L. R. 2 Ch. 459, 463, the plaintiff, who had lost large sums by speculating in the shares of a company, afterwards purchased a few shares for the purpose of bringing suit on account of mismanagement of the company's affairs, and it was held that he was not disqualified. See also *Salisbury v. Metropolitan Ry. Co.*, 38 L. J. Ch. 249, 251; and see cases in the following notes.

² See *Colman v. Eastern Counties Ry. Co.*, 10 Beavan, 1; *Ramsey v. Gould*, 57 Barb. 398; s. c. 8 Abb.

Pr. N. s. 174; *Camblos v. Philadelphia, &c. R. R. Co.*, 4 Brewster, 563, 591, 592; *Sandford v. Railroad Co.*, 24 Pa. St. 378.

³ See cases in the last two notes.

The opinion of the court in *Hawes v. Oakland*, 104 U. S. 450, is not in conflict with this doctrine. The rule formulated in that case, and subsequently promulgated as Equity Rule 94, was designed to prevent suits from being brought in the Federal courts by collusion, when they ought properly to be brought in the State courts. See *infra*, § 269.

holder, present or future, would be entitled to complain.¹ But where there has been no general acquiescence that binds the corporation, individual shareholders who have acquiesced retain their interest in the cause of complaint, although they are personally disqualified from suing;² and this interest would pass to a transferee of the shares. The latter would not necessarily be disqualified as a suitor because the prior holders were personally disqualified. If the transferee purchased the shares in good faith, and without notice of the fact that the prior holders had precluded themselves from suing, he would have as just a title to relief as if he had purchased from a shareholder who was under no disability.

It is eminently proper, however, that a purchaser of shares who was aware that the prior holder had barred his right to relief by acquiescence should also have no standing in court. Neither immediate justice nor public policy would require that the transferee, under these circumstances, should be accorded any greater rights than the transferor.³

§ 268. **Applications for preventive Relief.** — A purchaser of shares has at least as good a right as the prior holder to restrain the performance of an unauthorized contract made on behalf of the corporation. The purchaser is certainly entitled to insist that the company's agents shall do their duty after he has become a shareholder. He is entitled to insist that they shall not misapply the company's funds, and place its franchises in jeopardy, by doing unlawful acts under a contract which was never binding. And if the agents of the company do attempt, in violation of their duty, to carry out the void agreement, he can in good faith come into court and say that his rights are being infringed. Lord Chancellor Chelmsford said: "It never can be held that the acquiescence of the original holder of stock in illegal acts of the directors of a company will bind a subsequent holder of that stock to submit to all future acts of the same character."⁴

¹ *Infra*, §§ 605-610. *Kent v. Co.*, 1 Sm. & G. 142; *Re Syracuse, Quicksilver Mining Co.*, 78 N. Y. &c. R. R. Co., 91 N. Y. 1; *Kent v. Co.*, 159, 187, 188. *Quicksilver Mining Co.*, 78 N. Y. 159.

² *Supra*, § 262.

⁴ *Bloxam v. Metropolitan Ry.*

³ *Ffooks v. South Western Ry. Co.*, L. R. 3 Ch. 337, 354.

But the courts exercise their discretion in granting or withholding relief under these circumstances;¹ and it is clear that a purchaser of shares who has notice of equities affecting the rights of the prior holder is in no better position than the latter to ask for equitable relief.²

§ 269. *Practice in the Federal Courts.*—The Circuit Courts of the United States are authorized by act of Congress of 1875 to dismiss any suit in which it appears that the parties have been improperly or collusively made or joined for the purpose of creating a case cognizable under that act.³

The following Equity rule,⁴ was subsequently promulgated by the Supreme Court in order to guard against suits brought collusively by stockholders for the purpose of obtaining the jurisdiction of the Federal courts by reason of the citizenship of the parties:—

“Every bill brought by one or more stockholders in a corporation against the corporation and other parties, founded on rights which may properly be asserted by the corporation, must be verified by oath, and must contain an allegation that the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share had devolved upon him since by operation of law; and that the suit is not a collusive one to confer on a court of the United States jurisdiction of a case of which it would not otherwise have cognizance. It must also set forth with particularity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees, and, if necessary, of the shareholders, and the causes of his failure to obtain such action.”

¹ *Leo v. Union Pac. Ry. Co.*, 19 Fed. R. 283; and see *supra*, § 263. *v. Dean*, 106 U. S. 537; *Dimpfell v. Ohio, &c. Ry. Co.*, 110 U. S. 209; *Greenwood v. Freight Co.*, 105 U. S. 13, 16; *Dannmeyer v. Coleman*, 11 Fed. R. 97; *Leo v. Union Pacific Ry. Co.*, 17 Fed. R. 273; *Foot v. Cunard Mining Co.*, 17 Fed. R. 46; *McHenry v. New York, &c. R. R. Co.*, 22 Fed. R. 130.

² *Ffooks v. South Western Ry. Co.*, 1 Sm. & G. 142. Compare *Re Syracuse, &c. R. R. Co.*, 91 N. Y. 1.

³ Act of March 3, 1875, sec. 5.

⁴ Equity Rule 94, Preface to 104 U. S. Rep. With regard to the application of the rule, see *Detroit*

The abuses which led to the enactment of this rule are pointed out by Mr. Justice Miller, in delivering the opinion of the Supreme Court in the case of *Hawes v. Oakland*.¹

The Supreme Court has authority under the Judiciary Act to establish rules of practice, but not to alter the substantive law. Equity Rule 94 is mainly declaratory of the existing law; the only material change which it makes is to require the plaintiff to show that he was a shareholder at the time of the transaction of which he complains, or that his share has devolved upon him since by operation of law. This requirement was evidently designed as a rule of practice merely, and was deemed by the Supreme Court to be necessary in order to guard the courts from being imposed upon by collusion of the parties.

§ 270. **When a Shareholder is entitled to Relief. — General Rule.** — In the preceding sections, various principles have been discussed which determine the right of a shareholder to obtain relief in a court of equity on account of wrongs affecting his interest in the corporation. A general rule, applying to all the cases, may be stated in the following words: —

A shareholder is entitled to relief in a court of equity on account of any infringement of his equitable rights as member and beneficiary of a corporation, provided, first, that the corporation itself be unable, by reason of the default of its agents, to obtain an adequate remedy within a reasonable time; and, secondly, that the right to obtain redress for the injury be not impliedly relinquished by the shareholders to the discretion of the regular agents of the corporation, as a mutual concession for the sake of peace and good government.

§ 271. **What constitutes an Infringement of the Equitable Rights of a Shareholder.**² — The question what constitutes an infringement of the equitable rights of a shareholder in the corporate concerns presents no difficulties, in theory at least. A corporation and its shareholders are identical; it is a voluntary association, whose constitution is set forth in its charter or articles of association, and the general laws. Obviously, then,

¹ *Hawes v. Oakland*, 104 U. S. 450.

² This refers only to the collective rights of shareholders. *Supra*, § 235.

any injury to a corporation must be an injury to its shareholders; and it follows, that, subject to the limitations which have been pointed out, a shareholder is entitled to relief in equity on account of any wrong constituting an infringement of the corporate rights.¹

A suit of this character is brought to enforce the corporate or collective rights, and not the individual rights of the shareholders. It may therefore properly be regarded as a suit brought on behalf of the corporation,² and the shareholder can enforce only such claims as the corporation itself could enforce.³ Moreover, the essential character of a cause of action belonging to a corporation remains the same, whether the suit to enforce it be brought by the corporation or by a shareholder. Thus a *legal* right of action would not be treated as an equitable one, or become governed by the rules applicable to equitable causes of action, as to limitations, etc., because a shareholder has brought suit in equity to enforce it on behalf of the company.⁴

A shareholder who successfully prosecutes such an action on behalf of the corporation is ordinarily entitled to be reimbursed his reasonable expenses of the litigation, including attorney's fees, out of the corporate funds.⁵

§ 272. **Wrongs committed by Individual Shareholders.** — The same rule applies where a portion of the shareholders were parties to the wrong complained of. If some of the shareholders of a corporation are guilty of a wrong affecting the other shareholders only through their equitable interest in the company, the proper means of redress is through the corporation; and it is only when this remedy is not available that a shareholder can sue in his own name.

It is true that an act committed by a portion of the members of a corporation cannot, in the nature of things, be a wrong against the whole company; it can be a wrong only

¹ See *Dodge v. Woolsey*, 18 How. 331; *Pond v. Vermont Valley R. R. Co.*, 12 Blatchf. 280.

² *Supra*, § 257.

³ *Buford v. Keokuk, &c. Packet Co.*, 69 Mo. 611; see also *supra*, § 261.

⁴ *Pierson v. McCurdy*, 33 Hun, 520. Compare *Brinckerhoff v. Bostwick*, 99 N. Y. 185.

⁵ *Meeker v. Winthrop Iron Co.*,

17 Fed. R. 48.

against those shareholders who were not parties to the act. Yet it is impossible, under these circumstances, to work out the exact rights of the individual shareholders, except by regarding the corporation as a separate entity, and by treating the wrong as a wrong against the whole corporation. Each shareholder has an interest in the corporate concern as an entirety, and his rights must be protected accordingly. A recovery by the corporation as an entirety against a portion of its members would inure to the benefit of each shareholder in proportion to his interest. Those shareholders who were charged with liability irrespective of their membership in the corporation would be recouped to the extent of their interests through the enhancement of the value of their shares, and exact justice would thus be meted out to all the parties.

§ 273. **Acts causing a Forfeiture of Franchises or Stoppage of Business.**—Every shareholder has an interest in the continued existence of the corporation of which he is a member, and the preservation of the franchises which were granted to him and his co-corporators. No better cause for the interference of a court of equity at the suit of a shareholder can be stated, than that the managing agents of a corporation, or the majority, are about to do unauthorized acts, which would tend to bring about the destruction of the corporation itself, by forfeiture of its charter or otherwise. Such acts would cause irreparable injury to every dissenting shareholder.¹

Upon the same principle, the courts will interfere whenever the managing agents of a corporation cannot, or will not, properly carry on its business; as where two boards of directors both claim to be lawfully constituted, and neither will proceed to litigation in order to test the question, or where disputes have arisen between the properly constituted agents, causing a deadlock in the management of the corporate affairs.²

¹ *Rendall v. Crystal Palace Co.*, 4 K. & J. 326. See also *Pond v. Vermont Valley R. R. Co.*, 12 Blatchf. 280; *Bliss v. Anderson*, 31 Ala. 613; *Manderson v. Commercial Bank*, 28 Pa. St. 379; *Wiswall v. Greenville, &c. Plank Road Co.*, 3 Jones, Eq. 183; *Stewart v. Erie, &c. Transp. Co.*, 17 Minn. 372, 400; *Rogers v. Lafayette Agricultural Works*, 52 Ind. 304.

² *Pond v. Vermont Valley R. R. Co.*, 12 Blatchf. 280; *Featherstone v. Cooke*, L. R. 16 Eq. 298, *Lehigh*

A shareholder has a clear right to relief where the directors wrongfully refuse to call a meeting for the election of new officers, and a meeting cannot be regularly called except by action of the directors. The remedy under these circumstances is by bill in equity on behalf of the corporation,¹ or, when the obligation to call a meeting is imposed by statute or the charter, by writ of mandamus.²

§ 274. **Violations of the Charter Agreement.**—**Misapplication of Funds.**—The property of a corporation in equity belongs to its shareholders. It is contributed by them for the uses indicated in the charter, and no others. The agents of the company are invested by the shareholders with authority to manage the corporate affairs; but they have no authority beyond that which is conferred upon them by unanimous consent through the charter. If any of the agents of a corporation deal with the property or use the credit of the company for a purpose not authorized by the charter, this will be a good cause for complaint by any dissenting shareholder.

Even the majority have no right to direct the affairs of a corporation except in accordance with the provisions of its charter; for the powers of the majority are derived wholly from the agreement of the shareholders, as set out in the charter. Every individual shareholder has a right to stand upon his contract, and forbid any departure from its terms.³ It may, accordingly, be stated as a rule, that any departure from the chartered purposes of a corporation is an injury to every individual shareholder, for which the courts will, under proper circumstances, provide a remedy.⁴

Coal, &c. Co. v. Central R. R. Co., 35 N. J. Eq. 349. Compare *Einstein v. Rosenfeld*, 38 N. J. Eq. 309.

¹ Cases *supra*; *Lehigh Coal, &c. Co. v. Central R. R. Co.*, 35 N. J. Eq. 349; *Elkins v. Camden &c. R. R. Co.*, 36 N. J. Eq. 467, affirmed 37 N. J. Eq. 273.

² *People v. Cummings*, 72 N. Y. 433; *State v. Wright*, 10 Nev. 167; *People v. Governors of Albany Hospital*, 61 Barb. 397; *McNeely v.*

Woodruff, 13 N. J. Law, 352; *Regina v. Aldham, &c. Ins. Soc.*, 6 Eng. L. & Eq. 365; s. c. 15 Jur. 1035.

³ *Infra*, §§ 622-626; *Sellers v. Phoenix Iron Co.*, 14 Phila. 484.

⁴ The principles above stated have been acted upon in a large number of cases. See *Central R. R. Co. v. Collins*, 40 Ga. 582, 617; *Hazard v. Durant*, 11 R. I. 195; *Dodge v. Woolsey*, 18 How. 331;

§ 275. **Unauthorized Acts causing Liability.** — It follows, for the same reasons, that the agents of a corporation will be enjoined, at the suit of a shareholder, from issuing negotiable instruments in the name of the corporation for an unauthorized purpose; for negotiable instruments, though issued by an agent in excess of his authority, may become binding upon the company after they have passed into the hands of a *bona fide* purchaser.¹ The same principle and the same rule apply in case of an unauthorized issue of certificates for shares.²

It is clearly a good cause for the interference of a court of equity, that the managing agents of a corporation, or the majority of shareholders, in violation of their duty, refuse to defend suits brought against the company.³ Where there is

March v. Eastern R. R. Co., 40 N. H. 567; 43 N. H. 532; Sears v. Hotchkiss, 25 Conn. 175; Pratt v. Pratt, 33 Conn. 446; Kean v. Johnson, 1 Stockt. 401; Lauman v. Lebanon Valley R. R. Co., 30 Pa. St. 46; Taylor v. Miami Exporting Co., 5 Ohio, 162; Brewer v. Boston Theatre Co., 104 Mass. 378; Platteville v. Galena, &c. R. R. Co., 43 Wis. 493; Carpenter v. New York, &c. R. R. Co., 5 Abb. Pr. 277; Kelly v. Mariposa Land, &c. Co., 4 Hun, 632; Tippecanoe Co. v. Lafayette, &c. R. R. Co., 50 Ind. 86; Rogers v. Lafayette Agricultural Works, 52 Ind. 297; Tipton Fire Co. v. Barnheisel, 92 Ind. 88; Underwood v. New York, &c. R. R. Co., 17 How. Pr. 537; Stewart v. Erie, &c. Transp. Co., 17 Minn. 372, 398; Faulds v. Yates, 57 Ill. 416; Terwilliger v. Great Western Tel. Co., 59 Ill. 249; Chetlain v. Republic Life Ins. Co., 86 Ill. 220, 222; Knoxville v. Knoxville, &c. R. R. Co., 22 Fed. R. 758; Natusch v. Irving, Gow on Partn. 576; Beman v. Rufford, 1 Sim. n. s. 550; Winch v. Birkenhead, &c. Ry. Co., 5 De G. & Sm. 562; Charlton v. New Castle, &c. Ry. Co.,

5 Jur. n. s. 1096; Salomons v. Laing, 12 Beav. 339; Cohen v. Wilkinson, Id. 125; Colman v. Eastern Counties Ry. Co., 10 Beav. 1; Simpson v. Denison, 10 Hare, 51; Bagshaw v. Eastern Union Ry. Co., 7 Hare, 114; 2 MacN. & G. 389; Pickering v. Stephenson, L. R. 14 Eq. 322.

¹ Hoole v. Great Western Ry. Co., L. R. 3 Ch. 262; White v. Carmarthen, &c. Ry. Co., 1 H. & M. 786; Central R. R. Co. v. Collins, 40 Ga. 582. Compare *infra*, § 577.

² Fraser v. Whalley, 2 H. & M. 10; Hoole v. Great Western Ry. Co., L. R. 3 Ch. 262; Hutton v. Scarborough Cliff Hotel Co., 2 Dr. & Sm. 514, 521; Kent v. Quicksilver Mining Co., 78 N. Y. 159; 12 Hun, 53; Hoyt v. Quicksilver Mining Co., 17 Hun, 169. *Infra*, § 585.

³ Bronson v. La Crosse, &c. R. R. Co., 2 Wall. 302; Menier v. Hooper's Telegraph Works, L. R. 9 Ch. 350; Dodge v. Woolsey, 18 How. 331. A shareholder cannot file an answer and defend a suit in the name of the corporation, though the company's agents wrongfully refuse to make a defence; nor can he intervene merely because he holds all

reason to suspect that the directors are in collusion with parties who have brought suit against the corporation, the individual shareholders should be allowed to intervene.¹

§ 276. **Payment of Dividends.**—Every shareholder in a corporation is entitled to have the capital preserved unimpaired, for the purpose of carrying on the business for which the company was formed. Dividends can be paid only out of profits; and any attempt to distribute *capital* in the shape of dividends will be enjoined by a court of chancery, upon application of a dissenting member.² Profits earned by a corporation *may* be distributed as dividends, but this is not obligatory. The managing agents of the company have a discretionary power to determine the time and manner of making the payment; and they are, in many instances, authorized to reinvest the profits in the business of the company.³ This discretion cannot be impaired by the courts. But it should be remembered, that the ultimate object for which every ordinary trading corporation is formed is the payment of dividends to its individual members. If the agents of a company wrongfully refuse to distribute profits, when it is their duty to do so, a court of equity will grant relief at the suit of any shareholder.⁴

§ 277. **Individual and Collective Rights.**—If the agents of a corporation attempt to make a distribution of assets among the shareholders when they ought not to do so, or if they refuse to distribute profits when it is their duty to make a

the stock in the company. To warrant intervention by a shareholder, a case for equitable relief on account of the default of the company's agents must be shown. *Bronson v. La Crosse, &c. R. R. Co.*, 2 Wall. 283, 301; *Park v. Petroleum Co.*, 25 W. Va. 108.

¹ *Bayliss v. La Fayette, &c. Ry. Co.*, 8 Biss. 193.

² *Macdougall v. Jersey Imperial Hotel Co.*, 2 H. & M. 528; *Bloxam v. Metropolitan Ry. Co.*, L. R. 3 Ch. 337; *Salisbury v. Metropolitan Ry.*

Co., 38 L. J. Ch. 249; *Fawcett v. Laurie*, 1 Dr. & Sm. 192; *Carlisle v. Southeastern Ry. Co.*, 1 MacN. & G. 689; *Browne v. Monmouthshire Ry., &c. Co.*, 13 Beav. 32; *Coates v. Nottingham W. W. Co.*, 30 Beav. 86; *Carpenter v. N. Y., &c. R. R. Co.*, 5 Abb. Pr. 277.

³ See *infra*, § 427.

⁴ *Beers v. Bridgeport Spring Co.*, 42 Conn. 17; *Scott v. Eagle Fire Co.*, 7 Paige, 203. Compare *Stevens v. South Devon Ry. Co.*, 9 Hare, 313; *Pratt v. Pratt*, 33 Conn. 446.

distribution, this constitutes a violation of the collective rights of the shareholders. Individual shareholders can therefore sue only provided they have exhausted every means of obtaining redress through the corporation. Their claim would not be against the corporation, but through the corporation and on its behalf.¹

A different case is presented where the agents of a corporation attempt, while acting in the name of the company, to deprive individual shareholders of their rights of membership. Under these circumstances, those shareholders who are wronged may treat the wrong as one committed by the corporation through its agents against themselves personally, and may apply for relief accordingly. The plaintiffs' claim would be against the corporation, and not through the corporation against the parties who committed the wrong. The suit would not be in the form of an ordinary shareholders' suit, and it would not be necessary to show a previous demand upon the directors to proceed on behalf of the corporation.

Thus, if the shares of a member are unlawfully declared forfeited, it seems he may sue the corporation for the value of his shares,² or he may, by bill in equity annul the unauthorized forfeiture, and compel the agents of the company to issue to him a certificate of shares, and accord to him all the rights and privileges of membership.³ It has also been held repeatedly, that, where a member of an incorporated society or club has been wrongfully expelled, mandamus is a proper remedy to compel the corporation to restore him to membership.⁴

¹ *Supra*, § 235.

² *Supra*, §§ 212-218.

³ *Sweny v. Smith*, L. R. 7 Eq. 324; *Adley v. Whitstable Co.*, 17 Vesey, 315. Compare *Naylor v. South Devon Ry. Co.*, 1 De G. & Sm. 32; *Norman v. Mitchell*, 5 De G., M. & G. 648.

See *Pratt v. Taunton Copper, &c. Co.*, 123 Mass. 112; *Johnston v. Renton*, L. R. 9 Eq. 181-188; *Cot-*

tam v. Eastern Counties Ry. Co., 1 J. & H. 243; *Taylor v. Midland Ry. Co.*, 29 L. J. Ch. 731; 8 H. L. C. 751; *Sloman v. Bank of England*, 14 Sim. 475; *Telegraph Co. v. Davenport*, 97 U. S. 369.

⁴ *State v. Georgia Med. Soc.*, 38 Ga. 608; *Sibley v. Carteret Club*, 40 N. J. L. 295; *Evans v. Philadelphia Club*, 50 Pa. St. 107; *People v. Mechanics' Aid Soc.*, 22 Mich.

§ 278. An unauthorized act may be at the same time in violation of the individual rights of particular shareholders and of the collective rights of all the shareholders. In this case those shareholders who are specially injured would have a right to proceed individually against the company, while any shareholder might proceed by shareholders' bill against the wrong-doers, for the protection of the collective rights of the company. Any wrongful invasion of the rights of individual shareholders which might subject the corporation to a claim for damages, or which might injuriously affect the collective interests of all the shareholders, would seem to justify a proceeding in either form.¹

§ 279. **Unfair Discrimination among the Shareholders.** — The shareholders in a corporation are by the implied terms of their charter entitled to equal rights, unless the contrary be expressly provided.² If the agents of the company attempt to discriminate against individual shareholders, or to deprive them of their rights of membership, the parties aggrieved may sue for relief in equity. Under these circumstances, the only remedy is in equity, since the courts of law do not, as a rule, recognize the contractual relation between the members of a corporation and the individual rights resulting therefrom.

Thus, a bill in equity may be maintained by a shareholder to prevent an unfair distribution of the profits of the company,³ or an unfair distribution of a new issue of shares.⁴

86; *State v. Chamber of Commerce*, 20 Wis. 63; *Delacy v. Neuse River Nav. Co.*, 1 Hawks (N. C.), 274; *Commonwealth v. St. Patrick's Benevolent Soc.*, 2 Binn. 442.

It has been held that a bill in equity to restrain the Board of Trade of Chicago, and its officers, from expelling one of its members, cannot be maintained. *Sturges v. Board of Trade of Chicago*, 86 Ill. 441.

¹ In *Sweny v. Smith*, L. R. 7 Eq. 324, the suit was brought by the complainant on behalf of all the other shareholders to annul a forfeiture of

his shares. This form was probably not necessary, though entirely proper. The complainant had an independent cause of complaint beside that which was common to all the shareholders.

² *Infra*, § 302 *et seq.*

³ *Harrison v. Mexican Ry. Co.*, L. R. 19 Eq. 358; *Luling v. Atlantic Mut. Ins. Co.*, 45 Barb. 510; *Ryan v. Leavenworth, & Co. Ry. Co.*, 21 Kans. 366. But see *Jackson v. Newark Plank Road Co.*, 31 N. J. Law, 277.

⁴ *Dousman v. Wisconsin, & Co. Mining, & Co.*, 40 Wis. 418.

The same remedy may be obtained in order to prevent an unequal and unfair assessment, and to redress any injustice done to a portion of the shareholders in order to favor others.¹ The suit might be either in the form of a shareholders' bill, on account of the refusal of the company's agents to proceed against the wrong-doers, or in the form of a bill against the corporation for a specific performance of the plaintiff's individual rights. Where the wrong is done, or is threatened to be done, to a particular class of shareholders, the suit may be brought by the plaintiff on behalf of all those similarly interested.

§ 280. **Remedy of Holder of Preferred Shares.** — Where certain shareholders are entitled to privileges which do not belong to the other members of the company, the courts will provide a remedy for the infringement of these privileges by the other shareholders or the company's agents. Thus, it has been held repeatedly that a holder of shares, which confer a preference to the other shareholders, in the payment of dividends, is entitled to enforce his prior rights by bill in equity.²

§ 281. **The Courts will not interfere unnecessarily with the Management of a Corporation.** — A court of equity will grant all relief to a shareholder which the nature of his case may require. But it has always been a settled principle, that no interference with the management of a corporation can be justified, unless such interference be absolutely necessary to the attainment of justice.

The reason of this rule is obvious. The officers of a corporation are generally elected by vote of the shareholders. Every shareholder has a voice in their appointment, and may

¹ *Preston v. Grand Collier Dock Co.*, 11 Sim. 327; *Bailey v. Birkenhead, &c. Ry. Co.*, 12 Beav. 433; *Macon, &c. R. R. Co. v. Vason*, 57 Ga. 314, 316, 317.

² *Henry v. Great Northern Ry. Co.*, 4 K. & J. 1; 1 De G. & J. 606; *Sturge v. Eastern Union Ry. Co.*, 7 De G., M. & G. 158; *Smith v. Cork, &c. Ry. Co.*, Ir. Rep. 3 Eq.

356; *Bailey v. Hannibal, &c. R. R. Co.*, 1 Dill. 174; 17 Wall. 96; *Prouty v. Michigan Southern, &c. R. R. Co.*, 1 Hun, 655; *Thompson v. Erie Ry. Co.*, 45 N. Y. 468; *Boardman v. Lake Shore, &c. Ry. Co.*, 84 N. Y. 157, 180. See also *infra*, § 442.

As to rights of holders of preferred shares, see *infra*, §§ 436-441.

insist that they shall represent the corporation when duly appointed. If an officer is guilty of a breach of duty, he may in many cases be removed by act of the corporation; but no minority of the shareholders have any authority to restrain his action, or remove him and appoint another officer in his place. Nor can a court of chancery interfere at the suit of a portion of the shareholders and remove an offending officer, or even enjoin him generally from acting for the corporation, unless this be essential to the protection of the corporate rights; as, for example, where the directors have conspired to defraud the corporation, or have otherwise shown themselves to be totally unfit to be intrusted any longer with the management of the company's affairs. The court must ordinarily confine its remedy to the redress of the specific wrongs which have been charged.¹

The appointment of a receiver or manager of a *solvent* corporation must therefore be considered a strong remedy, which can be justified only in a strong case; and the management of the corporation should be restored to its shareholders as soon as this can be done with safety. Thus, in *Featherstone v. Cooke*,² Vice-Chancellor Malins appointed a receiver for a company because disputes had arisen between its managing agents, which caused a stoppage of the business and threatened to entail great loss upon the shareholders; but he discharged the receiver as soon as a general meeting of the shareholders had been called and new officers had been chosen.

§ 282. **Winding up a Corporation at the Suit of a Shareholder.** — There is a distinction between the legal dissolution of a corporation by extinguishment of its franchises, and a mere cessation of business and distribution of assets. In the former case, the corporate association is wholly destroyed in

¹ *Converse v. Dimock*, 22 Fed. R. 573; *Bayless v. Orne*, 1 Freem. Ch. (Miss.) 161; *Neall v. Hill*, 16 Cal. 146, 148. See *Hardon v. Newton*, 14 Blatchf. 376.

² *Featherstone v. Cooke*, L. R. 16 Eq. 298; *Stevens v. Davison*, 18 Gratt. 819; *Waterbury v. Merchants' Union Exp. Co.*, 50 Barb. 158; s. c. 3 Abb. Pr. n. s. 163; *Belmont v. Erie Ry. Co.*, 52 Barb. 637. See *Lawrence v. Greenwich Fire Ins. Co.*, 1 Paige, 587. *Infra*, § 523.

contemplation of law, in the latter case, it does not necessarily cease to exist.

It is well settled that the shareholders in a corporation have no power to extinguish its charter and dissolve it; nor can a court of chancery dissolve it at their request. In the absence of a statutory provision, the franchises of a corporation can be declared forfeited and extinguished only at the suit of the State in an appropriate proceeding at law; and chancery has no jurisdiction whatever to declare them forfeited at the suit of a shareholder or of a stranger to the company.¹

§ 283. **When the Court will refuse to wind up a Company.** — If the charter of a corporation fixes its duration at a definite period of time, it is part of the agreement of the shareholders that the company shall continue in operation at least during the time limited;² and if no definite time is fixed, it is implied that the duration of the company shall be indefinite.³ In some instances the majority of shareholders have a discretionary power to wind up the company's business, whenever they deem this to be desirable and in the interest of the whole association.⁴ But in no case have the minority any such power. If shareholders in a corporation disapprove of the company's management, or consider their speculation a bad one, their remedy is to elect new officers, or to sell their shares and withdraw. They cannot insist on having the company's business closed, and the assets distributed, against the will of a single shareholder, who wishes to have the business continued. It is clear, therefore, that the courts cannot interfere at their suit, and order the company to be wound up.⁵

¹ *Infra*, §§ 982, 990. *Strong v. Ry. Co.*, 52 Barb. 637; *Denike v. New York, &c. Lime, &c. Co.*, 80 N. Y. 599; *Bliven v. Peru Steel, &c. Co.*, 60 How. Pr. 280; *Hardon v. Newton*, 14 Blatchf. 376; *Re Louisiana Savings Bank, &c. Co.*, 35 La. Ann. 196; *Baker v. Backus*, 32 Ill. 79; *Fountain Ferry Turnpike Co. v. Jewell*, 8 B. Monr. 140.

² *Infra*, § 418.

³ See *infra*, § 411.

⁴ *Infra*, §§ 412, 413.

⁵ *Bayless v. Orne*, 1 Freem. Ch. (Miss.) 161; *Neall v. Hill*, 16 Cal. 146; *Howe v. Deuel*, 43 Barb. 504; *Waterbury v. Merchants' Union Exp. Co.*, 50 Barb. 158; *Belmont v. Erie*

§ 284. **When Relief granted.** — The general rule stated in the preceding section is not without exception. Whenever, in the course of events, it proves impossible to attain the real objects for which a corporation was formed, or when the failure of the company has become inevitable, it is the duty of the company's agents to put an end to its operations, and to wind up its affairs.¹ Under these circumstances, the majority would have no right to continue to use the common property and credit for any purpose, because it would be impossible to use them for any purpose authorized by the charter. If the majority should attempt to continue the company's operations in violation of the charter, or should refuse to make a distribution of the assets, any shareholder feeling aggrieved would be entitled to the assistance of the courts; and a decree should be made ordering the directors to wind up the company's business, and distribute the assets among those who are equitably entitled.²

§ 285. However, before the courts can thus interfere with the management of a corporation, and order its business to be wound up, it must be shown very plainly that the business

¹ *Infra*, § 411. If a corporation is formed to continue only for a definite period of time, and the agents of the company neglect to wind it up at the expiration of the time prescribed, any shareholder may file a bill in equity for that purpose. *Merchants', &c. Line v. Waganer*, 71 Ala. 581.

² In *Cramer v. Bird*, L. R. 6 Eq. 143, a shareholder filed a bill to compel the directors of a corporation which had ceased to do business to make a distribution of the assets. Lord Romilly, M. R. said (on page 148): "I am of opinion that there cannot be a plainer equity than this: that where the functions of a corporation have ceased, the managers of that corporation are bound to account for all moneys belonging to the corporation; and when such

moneys are improperly retained, this court will make a decree in order that they may be divided among the various members."

See also cases cited in next section, and compare *Baring v. Dix*, 1 Cox, 213; *Bailey v. Ford*, 13 Sim. 495; *Jennings v. Baddeley*, 3 K. & J. 78.

The court must take into consideration the whole state of affairs at the time of the application. *Neville v. Litchfield Carriage Co.*, 47 Conn. 167. It has been held that all the shareholders must be made parties to the suit. See *Croft v. Lumpkin Chestatee Mining Co.*, 61 Ga. 465.

Upon winding up a corporation, the shareholders have no claim at law to a distribution of the assets; their rights are cognizable in equity only. *Brown v. Adams*, 5 Biss. 181.

cannot possibly be carried on any further without a departure from the company's charter; a court of chancery cannot impair the discretionary powers conferred upon the majority by the charter, and decide on their behalf whether the continuance of the enterprise be advisable as a commercial speculation. The rule was laid down by Lord Cairns, L. J., in the *Suburban Hotel Company's* case, as follows: "If it were shown to the court that the whole substratum of the partnership, the whole of the business which the company was incorporated to carry on, has become impossible, I apprehend the court might, either under the act of Parliament or on general principles, order the company to be wound up. But what I am prepared to hold is this, that this court and the winding-up process of the court cannot be used as the means of evoking a judicial decision as to the probable success or non-success of a company as a commercial speculation."¹

Even where it is plain that the business of a company ought to be wound up, the courts cannot appoint a receiver, unless the agents of the company are unwilling or unable to act; and where the charter provides particular agents to act as liquidators on dissolution of the company, the agents so appointed cannot be displaced unless they are guilty of fraud.²

§ 286. **The Effect of an unauthorized Issue of Certificates declaring Shares to be paid up.** — Every shareholder in a corporation is entitled to insist that every other shareholder shall contribute his ratable part of the company's capital for the common benefit; and the fund thus created must be adminis-

¹ *In re Suburban Hotel Co.*, L. R. 2 Ch. 737, 750; *In re Joint Stock Coal Co.*, L. R. 8 Eq. 146; *Pratt v. Jewett*, 9 Gray, 34. See also *In re European Life Ass. Soc.*, L. R. 9 Eq. 122; *Salem Mill Dam Co. v. Ropes*, 6 Pick. 23; *Redmond v. Enfield Manuf. Co.*, 13 Abb. Pr. N. S. 332; *Lafond v. Deems*, 81 N. Y. 507; *Denike v. New York, &c. Lime, &c. Co.*, 80 N. Y. 599; *Bliven v. Peru Steel, &c. Co.*, 60 How. Pr. 280.

A suit to wind up the business of a corporation will not as a rule be entertained outside of the State where the corporation was formed. The court must have jurisdiction over the parties, and have the power of distributing the assets of the company, in order to do justice in such a proceeding. *Wilkins v. Thorne*, 60 Md. 253.

² *Follett v. Field*, 30 La. Ann. 161.

tered by the agents of the company with strict impartiality, according to the terms of the charter, in the interest of all the associates. It would be a plain violation of the equitable rights of those shareholders who have contributed, or who have incurred a liability to contribute, the amount of their shares in full, to allow any person to have the benefits of membership without adding the amount of their shares to the company's capital.¹ It follows, therefore, that directors have no authority to declare shares to be paid up unless they have in fact been paid up. If the directors of a company wrongfully issue a certificate for paid-up shares on account of shares which have not been paid up, their act will not bind the company, and the certificate may be repudiated.

However, certificates of shares have a negotiable character; a *bona fide* purchaser of a certificate of shares, issued by the proper agents of the company in regular form, is entitled to assume that the certificate was issued rightfully. If a certificate thus issued states that the shares which it represents are fully paid up, this statement will bind the corporation as against a *bona fide* purchaser without notice, and no further calls can be made upon the shares.² It is evident, therefore, that an unauthorized issue of certificates for paid-up shares, in the usual form, like an unauthorized issue of negotiable paper, would threaten the corporation with irreparable injury. In either case, the corporation would have a plain right to call upon the courts for the protection of its rights by injunction.

It follows, for the same reasons, that, after certificates for paid-up shares have been issued without authority, the corporation may maintain a suit to procure their cancellation before they have reached the hands of a *bona fide* purchaser; and if the corporation is unable to act, a shareholder may sue in his own name for the protection of his equitable rights.³

§ 287. It is to be observed that the unauthorized issue of a certificate for paid-up shares to a person who has incurred a liability to the corporation to pay up the shares, before he

¹ *Infra*, § 305.

³ *Supra*, § 275.

² *Infra*, §§ 306, 816.

has fully paid them up, would ordinarily not injure the corporation, unless the first taker of the certificate has become insolvent, and has transferred the certificate to an innocent purchaser.

A certificate for paid-up shares is merely a written statement, in the name of the corporation, that the holder is a shareholder, and that his shares have been paid up. If the certificate is issued by the proper agents, the corporation is estopped from denying the truth of the statements it contains, as against innocent purchasers in due course of business. But the corporation is not bound by a certificate issued by its agents, without authority and in violation of their duties, as against a person who has notice of the want of authority.

If a certificate for shares is issued to a person who is not a shareholder, or entitled to become a shareholder, it is void in his hands, and the corporation is entitled to call it in for cancellation, lest it should pass into the hands of an innocent purchaser and thus become binding. The same is true where a certificate for paid-up shares is wrongfully issued to a shareholder who has not paid up his shares. The untrue statement in the certificate that the shares are paid up would certainly not discharge the shareholder from his liability, although it would prevent a recovery against a *bona fide* transferee. It would have no greater effect than the unauthorized issue of a receipt to a person indebted to the corporation. In this case the debtor would not be discharged, and the corporation would lose nothing.

It follows, therefore, that if the agents of a corporation without authority issue a certificate for paid-up shares to a subscriber, or to a person liable to contribute the amount of the shares, this alone does not render the agents who wrongfully issue the certificates liable to the corporation for the amount of the shares. The corporation would suffer no loss, as its rights against the debtor would remain unimpaired. If, however, the certificates have passed into the hands of innocent purchasers, and the person to whom they were wrongfully issued has become insolvent, the corporation would have

a claim for damages against those who caused it to lose the value of the shares by wrongfully issuing the certificates.

§ 288. **The real Character of an original Issue of Shares.** — A private business corporation means an association of shareholders; it can no more exist without shareholders, than the whole body can exist without the parts which make it up. In some instances a corporation may be deemed in existence before it has any shareholders, but this must be by the use of a fiction: neither the courts nor the legislature can create a real association in the absence of associates.¹

Before shares in a corporation have been issued, the unissued shares are, strictly speaking, not shares at all; there is merely a *power to issue shares*. But, inasmuch as the shares go into effect as shares at the moment of issue, they may be dealt with and sold by those having the power to issue them in the same manner as if they were things in existence. Similarly, the maker of a promissory note may sell his note for a large sum of money, although it be but a valueless piece of paper in his own hands. The sale is merely a form by which new rights and obligations are created.

Shares in a corporation represent fractional interests in the entire corporate concern, and their value necessarily depends upon the real capital which the company owns. The whole and the sum of its parts must be equal.

The power to issue the shares in a corporation, before any have in fact been issued, is worth nothing more than the value of the company's franchise, or, under the general laws, the trouble of forming the company. It is as easy to form a corporation with a nominal capital of a million of dollars as with a nominal capital of a hundred dollars, and all the shares in the one company, before issue, would be worth no more than all the shares in the other. In either case they would be worth neither more nor less than the purchaser put into the treasury of the company.²

¹ See *supra*, § 33.

² These facts are recognized in the following cases: *Schenck v. Andrews*, 57 N. Y. 150, *per Reynolds, C.*; *Burrall v. Bushwick R. R.*

Co., 75 N. Y. 216, *per Folger, J.*; *Williams v. Western Union Tel. Co.*, 93 N. Y. 162, 189, *per Earl, J.*; *Sturges v. Stetson*, 1 Biss. 246.

The case would be different where part of the shares in the corporation have been issued, and the company is the owner of something of value. The holders of the issued shares would in reality constitute the corporation, and would be the real owners of the whole concern. The corporation would not in reality be the holder of the unissued shares, for it is self-evident that the whole body cannot be a member of itself.¹ However, by a convenient if not necessary fiction, the corporation may be regarded as the owner of its unissued shares, dealing with them like an individual. The issue of new shares usually takes the form of a sale by the corporation to the incoming member.² The latter, by becoming a shareholder, would obtain a fractional interest in the entire corporate concern at the expense of the existing shareholders, and would add to the company's capital the amount paid for his shares. Justice to the existing shareholders would therefore require that the incoming shareholder should contribute the full value of the fractional interest obtained. Under ordinary circumstances, the value of this fractional interest would be measured by the market value of the shares, provided the shares have a fair market value.

§ 289. **Causes of Action arising from an unauthorized Issue of Certificates declaring Shares to be paid up.** — The general rule is that shares in a corporation may not be issued as paid up for less than their nominal value. To issue shares as paid up without increasing the company's real capital to the amount represented, would primarily be a violation of the law and a public wrong. It would be a cause for dissolving the company at the suit of the State, and might subject those who violated the law to proceedings of a criminal nature. But the public wrong would not alone enable a private individual to proceed in the courts of civil jurisdiction. A shareholder cannot complain unless he can show that his equitable interests have been infringed,³ nor can creditors sue without showing some specific injury to themselves.⁴ The rights of creditors need not be considered in this connection.

¹ Compare *supra*, § 112 *et seq.*

² *Supra*, § 61.

³ *Supra*, §§ 260-267.

⁴ Existing creditors of a corpora-

However, any act of the directors of a corporation which would subject the company to a forfeiture of its franchises would evidently impair the private rights of the shareholders.¹ Shareholders are therefore clearly entitled to object to an illegal issue of certificates of paid-up shares, and may restrain such issue by injunction, or obtain a cancellation of certificates after they have been issued, provided they have not passed into the hands of *bona fide* purchasers.

The right of a shareholder to sue on behalf of the corporation for compensation on account of an illegal issue of certificates of paid-up shares which cannot be cancelled, is based on the ground that his fractional interest in the whole corporate concern has been thereby impaired. He may complain because a right to share in the company has been given to another party for less than its real or market value, and without his consent.²

The proper complainant under these circumstances would primarily be the corporation, representing the collective rights of all the shareholders, and it is only when the corporation is disabled from suing that the shareholders can proceed in their own names. The parties who caused the loss to the company by wrongfully issuing and negotiating the certificates would be the proper defendants to the suit.

The measure of damages in a suit of this description would be the actual loss suffered by the corporation, as representative of the collective rights of all the shareholders. This would not necessarily be the nominal amount of the shares; it would be the difference between the amount received by the corporation and the *real value* of the shares represented by the certificates. The damages to the company might exceed or fall below the nominal amount of the shares, according to their real value.³

tion are certainly not injured by the issue of shares at less than their par value, and it is plain that future creditors cannot justly say that they were injured by an issue of shares which took place before their claims arose. Their complaint must be based on the fraud in representing

the company's capital as greater than its real amount. *Infra*, §§ 804, 809-819.

¹ *Supra*, § 273.

² *Infra*, § 306.

³ *Continental Tel. Co. v. Nelson*, 49 N. Y. Super. Ct. 197, 200.

§ 290. **Ratification by Shareholders of an unauthorized Issue of Certificates.**—The rule that a corporation is bound by an unauthorized act of its agents, after the act has been ratified by all the shareholders, applies to an unauthorized issue of certificates for shares. It is true that the unanimous consent of the shareholders cannot cure the illegality of issuing certificates in violation of the law; and where certificates are issued in violation of a statutory prohibition, which renders them absolutely void in legal effect, the corporation may be entitled, or even be obliged, to repudiate them, though issued with the unanimous consent of its members. But, under these circumstances, the corporation cannot complain against those who issued the certificates, inasmuch as it has suffered no injury, having consented to the unauthorized act. The mere fact that the law has been violated, certainly cannot be made the basis of a civil action for damages.¹ It follows *a fortiori* that a shareholder cannot sue on behalf of the corporation. This was the decision in *Parsons v. Hayes*,² a suit brought by a shareholder in a mining corporation formed under the general law of New York, of 1848. This law provides that any three or more persons may form a corporation, by filing a certificate setting forth the objects of the company, the amount of its capital stock, the names of the directors for the first year, and other particulars. It declares that the corporation should be deemed in existence from the time of filing the certificate, and invests the directors with authority to receive subscriptions, make calls, and issue certificates of shares; but it prohibits the directors from issuing the shares as paid up, except for their par amount in money, or property deemed in good faith to be of equal value.

In the case referred to, the directors named in the certifi-

¹ *Flagler Engraving, &c. Co. v. Co.*, L. R. 11 Ch. Div. 701. Compare *Re British, &c. Box Co.*, L. R. Flagler, 19 Fed. R. 468.

² *Parsons v. Hayes*, 14 Abb. 17 Ch. Div. 467. See also *Union N. C. 419*; s. c. 50 N. Y. Super. Ct. 29; *Langdon v. Fogg*, 18 Fed. 135 Mass. 367; *Scovill v. Thayer*, R. 5. To the same effect, see *Re 105 U. S. 143, 153. Contra semble, Ambrose Lake, &c. Mining Co., Society, &c. v. Abbott*, 2 Beav. L. R. 14 Ch. Div. 390; *Re Gold 559.*

cate of incorporation issued paid-up certificates for *the entire capital stock* of the company, amounting nominally to two millions of dollars, in payment for a mine which was known to be worth less than one hundred and fifty thousand dollars. The vendor of the property thereupon, in pursuance of a previous arrangement with the directors, turned over to them a portion of the stock which had been issued to him, and the shares were subsequently transferred to innocent purchasers.

The plaintiff, claiming to be a *bona fide* purchaser of his shares, brought suit in the form of an ordinary shareholders' bill, and made the corporation and the directors who had first issued the stock defendants. The plaintiff's position was, that the individual defendants were liable to account to the corporation for the difference between the nominal amount of the stock issued by them, viz. \$2,000,000, and the real value of the property received in payment, viz. \$150,000; or at least that they were liable for the profits derived from the sale of the stock which had been turned over to them in pursuance of their agreement with the vendor of the property. The court however held, on demurrer, that the defendants were not liable in either respect, and that the complaint did not state a cause of action. The ground of the decision was, that, inasmuch as the acts of the defendants were performed with the consent and at the instance of the holders of the entire capital stock, neither the corporation nor its stockholders suing on its behalf could complain.

This decision was clearly right. The absurdity of the plaintiff's claim becomes apparent, when it is considered that there was no corporation in existence until the issue of shares which constituted the alleged injury to the corporation had taken place. It is true, the statute declared that the signers of the certificate of incorporation should be a corporation, but this at most constituted them a *quasi* corporation, to be succeeded by the real corporation, consisting of the stockholders, when the stock was issued.¹

The vendor of the property in truth took back what he gave. He placed the property in the corporate name, and at

¹ *Supra*, § 33.

the same time practically became the corporation by becoming its sole stockholder. Evidently, therefore, no person was injured by that transaction. If subsequent transferees of shares were deceived by the false representations that the amount of the shares had in fact been paid into the treasury of the company, their claim should have been for the damages caused to themselves individually through the false representations, and not for an infringement of the collective or corporate rights of all the shareholders.

§ 291. *Frauds by Promoters.* — *New Sombrero Co. v. Erlanger.* — The case of *Parsons v. Hayes*, referred to in the preceding section, must be carefully distinguished from a class of cases involving the liability of promoters of companies, on account of frauds practised by them upon persons who afterwards form the company by subscribing for shares.¹

New Sombrero Phosphate Company v. Erlanger,² is a leading case of this class. The defendants had purchased a lease of an island containing phosphate deposits, and formed a plan of disposing of the property at a large profit, by getting up a company expressly to buy it. Accordingly, the memorandum and articles of association of a limited company were drawn up, and five directors were therein named to manage the company. A contract was then submitted to the directors, and approved by them, by which the company agreed to purchase the property, from an agent to whom the defendants had transferred it, for a price which was in excess of the value of the property, and much larger than the price previously paid by the defendants. The directors representing the company were selected by the defendants, and entirely under their control; they did not investigate the value of the property before approving of the contract, and did not in good faith look after the interests of the shareholders who were to contribute the money, but allowed themselves to be made the tools of the defendants. A prospectus having been issued referring to this contract, subscriptions for shares

¹ As to the relation between a company and its promoters, see *infra*, § 525.

² *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73; affirmed L. R. 3 App. Cas. 1218.

were solicited, and the purchase was carried out with the money contributed by the subscribers.

When the true facts became known to the shareholders, and it was discovered that the approval of the directors had been a mere sham, a new board was elected, and a bill was filed in the name of the company to set aside the sale, and to recover the purchase money upon restoring the property to the defendants. Both the court of appeal¹ and the House of Lords² held that the company was entitled to the relief prayed. The ground of the decision in each case was, that the promoters occupied a fiduciary relation to the shareholders forming the company, and that they were responsible for the fraud practised upon the company through the medium of the board of directors. Lord Cairns, the Lord Chancellor, said: "I do not say that the owner of property may not promote and form a joint-stock company, and then sell his property to it, but I do say that, if he does, he is bound to take care that he sells it to the company through the medium of a board of directors, who can and do exercise an independent and intelligent judgment on the transaction, and who are not left under the belief that the property belongs, not to the promoter, but to some other person."³

§ 292. There can be no doubt that a gross fraud was perpetrated in this case, and that the shareholders were entitled to relief in some form. The only question requiring consideration is whether the proper remedy was pursued in bringing suit in the name of the company, or whether the shareholders should have sued individually for the damages caused by the deceit. It has been pointed out, that, where the separate rights of shareholders have been infringed, they

¹ L. R. 5 Ch. Div. 73.

² L. R. 3 App. Cas. 1218. The opinions delivered by Lord Blackburn (page 1264) and by Lord Cairns (page 1234) are particularly instructive.

³ L. R. 3 App. Cas. 1236. This principle was acted upon in the following cases: *Simons v. Vulcan Oil, &c. Co.*, 61 Pa. St. 202; *Bag-*

nall v. Carlton, L. R. 6 Ch. Div. 371; *Phosphate Sewage Co. v. Hartmont*, L. R. 5 Ch. Div. 395; *Beck v. Kantorowicz*, 3 K. & J. 230; *Mason v. Harris*, 11 Ch. Div. 97; *Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221. Compare *Albion Steel, &c. Co. v. Martin*, 1 Ch. Div. 580.

must sue individually, and where their collective or corporate rights have been infringed, the company is the proper plaintiff.¹ In the latter case, an individual shareholder cannot sue unless the company is disabled.

It will be observed, that the original approval by the directors of the fraudulent contract which had been gotten up by the promoters was not an injury to the company or its shareholders, because there were no innocent shareholders at that time. The fraud upon the shareholders was not consummated until they were induced to subscribe for their shares, and pay their money into the company's treasury, upon the implied representation that the contract had been made in good faith in their interest.

But it is necessary to look into the real nature of the transaction somewhat further. Before any shares had been issued, the existence of the company was a fiction. The shareholders really formed the company, each one becoming a member when he took his shares. While the contract for the purchase of the property was nominally in force from the time of its approval by the board of directors, yet it really took effect only after the shareholders had taken their shares. It then became binding upon all the shareholders collectively, or, in other words, on the company. The fraud really consisted in inducing the shareholders to enter into this contract in their collective capacity, and in using the funds belonging to the shareholders collectively in paying the purchase price. It is evident, therefore, that the injury to the shareholders was an injury to their collective or corporate interests, and that the company was the proper complainant.

On the other hand, in *Parsons v. Hayes*, and *Re Ambrose Lake, &c. Mining Co.*,² the collective rights of the shareholders were not infringed. The charge made in these cases was, that the directors had issued the entire stock of the company as paid-up stock for property worth less than the par amount. No person was injured in the least degree by these transactions. If the persons to whom the stock was first issued

¹ *Supra*, § 235. See per Lord Vigers *v. Pike*, 8 Cl. & F. 647. Blackburn, L. R. 3 App. Cas. 1264; ² *Supra*, § 290.

afterwards sold a portion of it, and deceived the purchasers by a false representation that the par value of the shares had been paid into the company's treasury, they would clearly be liable to the purchasers for the fraud. And under these circumstances the directors who issued the false certificates representing that the company's capital had been paid up according to law might perhaps be charged also by reason of their complicity. But in a case of this kind the plaintiff's claim would be merely for the damages caused by the deception, and the extent of the injury would depend in each case upon the price paid by the plaintiff for the shares, and their market value when the deception was discovered.

§ 293. There is a class of cases differing in some respects from either of the cases referred to in the preceding sections. A person who induces others to join him in a partnership or other joint transaction cannot obtain a secret profit out of the transaction without giving his associates the benefit of it; an attempt to do so is an attempt to commit a fraud, and will not be allowed to prevail.

Thus, if a person should induce others to join him in the purchase of property, by representing that the property can be bought for a certain price, and the price so paid really includes a commission or profit to himself, any of the associates or joint purchasers may withdraw from the transaction on discovering the fraud; and if a rescission cannot be effected, he may recover his share of the profits wrongfully appropriated by the promoter of the scheme. The promoter would also be liable for any damages caused by the deceit, if a positive misrepresentation was practised.¹

However, there is no rule of law prohibiting a person from forming a company for the purpose of selling property to it and making a profit by the sale. The law merely requires that such a transaction be entirely open and free from deception upon the company and those who become its members. This rule applies equally to corporations and to unincorporated associations.

¹ See *Short v. Stevenson*, 63 Pa. 504; 9 Hun, 603; s. c. 54 N. Y. St. 95; *Getty v. Devlin*, 70 N. Y. 403.

§ 294. **Complicity of Part of the Shareholders no Ground for withholding Relief.** — The right of a corporation to sue, on account of frauds of its promoters involving a misapplication of corporate funds, is not affected by the complicity of individual shareholders in the acts complained of. The remedy for an infringement of the corporate or collective interests must necessarily be obtained by or through the corporation; ¹ if there are collateral equities between the wrongdoers and part of the shareholders, these must be adjusted by proceedings directly between them. But even if the law should not provide a remedy for the adjustment of these collateral equities, it is clear that the innocent shareholders ought not to be made to suffer by refusing to permit the corporation to sue for the protection of the corporate interests.

Accordingly, in *New Sombrero Phosphate Co. v. Erlanger*,² the corporation was allowed to recover against the promoters, although some of the shareholders were parties to the acts complained of. In reply to the argument that it would be unfair to allow those shareholders who were not wronged to benefit by a recovery in the name of the corporation, Sir George Jessell, Master of the Rolls, said: "If the argument were once allowed to prevail, it would only be necessary to corrupt one single shareholder to prevent a company from ever setting the contract aside. It may be said you give to the shareholder who was a party to the fraud a profit, because he will take it in respect of his shares, and since, as between the conspirators there is no contribution, therefore his brother conspirators who are made liable for the fraud cannot make him repay his proportion. But the doctrine of this court has never been to hold its hand, and avoid doing justice in favor of the innocent, because it cannot apportion the punishment fully amongst the guilty."³

§ 295. **Restraining the Use of the Funds of a Corporation to procure an Alteration of its Charter.** — It is a clear case for the interposition of a court of equity, at the suit of a shareholder, if any portion of the property or funds of a corporation are

¹ *Supra*, § 272.

² *Supra*, § 291.

³ *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 114.

used without authority, by those having control of them, in order to procure an act of the legislature altering the charter of the corporation.¹

In the United States, the legislature has ordinarily no power to alter the charter of a corporation without the consent of its shareholders, and an attempted alteration of a charter by statute would be wholly ineffective until unanimously accepted by the company.² Hence the use of corporate funds in order to procure a statute authorizing an alteration of a charter would, in the United States, be a naked misapplication of corporate funds from the uses declared in the charter. In England, Parliament is not restrained by constitutional prohibition from impairing the obligation of contracts; and the use of the funds of a corporation without the authority of the shareholders, in order to procure the passage of an act of Parliament peremptorily changing its charter, would involve, not merely a simple misapplication of trust funds, but the use of trust funds for the purpose of attacking the life and existence of the trust itself.

§ 296. **Restraining the Use of the Corporate Name for the Purpose of procuring an Alteration.** — A corporation, like an individual, will be protected by the courts from an unauthorized use of its name by a stranger.³ And if the managing agents of the corporation refuse to interfere on its behalf, the shareholders may apply directly to a court of equity for relief. The same rule applies if the *agents* of a corporation use its name without authority; for the agents of a corporation, and even the majority of the shareholders, must ultimately derive all their powers from the company's charter, and they have no right to use the corporate name for any purpose which the charter does not authorize.

Any shareholder may enjoin the managing agents of a corporation from using the corporate name for an unauthorized

¹ *Lyde v. Eastern Bengal Ry. Co.*, 36 Beav. 10; *Munt v. Shrewsbury, &c. Ry. Co.*, 13 Beav. 1; *Ware v. Grand Junction Water Co.*, 2 R. & M. 470; *Maunsell v. Midland, &c. Ry. Co.*, 1 H. & M. 130; *Simpson v. Denison*, 10 Hare, 51, 61; *Stevens v. Rutland, &c. R. R. Co.*, 29 Vt. 548.

² *Infra*, Chapter XV.

³ *Newby v. Oregon, &c. Ry. Co.*, Deady, 609; *Holmes v. Holmes, &c. Manuf. Co.*, 37 Conn. 278.

purpose, if material injury to the corporation might possibly result therefrom; as, for example, by signing the corporate name to negotiable instruments for an improper purpose.¹ A still stronger case is presented if any person or persons, without authority in that behalf, assume to apply to Parliament in the name of a corporation for a peremptory change of its charter. And it matters not that such application was sanctioned by the directors of the corporation, or a majority vote of the shareholders; for, unless the authority be conferred by the charter, neither directors nor the majority can represent a corporation against the will of any member. An unauthorized assumption of authority to represent a corporation, for the purpose of destroying its charter, would not only be a fraud upon the legislature, but an invasion of the rights of the non-consenting stockholders, which a court of equity would prevent by injunction.² The question whether or not the courts have jurisdiction to restrain an unjust application to the legislature does not arise under these circumstances; the question is merely whether or not the courts will enjoin an unauthorized and perhaps fraudulent use of the corporate name.

In America, however, where the legislature cannot impair the validity of a charter without the consent of all of its shareholders, unless the right of making alterations was expressly reserved to the legislature, ordinarily no injury would ensue from an attempted alteration by legislative act.³

§ 297. **Restraining Action under an attempted Alteration.**—A majority of the shareholders in a corporation have no implied authority to accept an alteration of the company's charter, and an attempt to accept an alteration without authority is wholly ineffective. A plain case for the interposition of a court of equity is established, where it is shown that

¹ *Supra*, § 275.

² Compare *Ward v. The Society of Attornies*, 1 Coll. 370; *Cunliff v. Manchester, &c. Canal Co.*, 2 R. & M. 480, note; *Re London, &c. Ry. Act*, L. R. 5 Ch. 671, *per James*,

L. J.; but see *Ware v. Grand Junction Water Co.*, 2 R. & M. 470, 484.

³ *Stevens v. Rutland, &c. R. R. Co.*, 29 Vt. 560.

the managers of a corporation are about to use the company's property or credit in pursuance of an alleged alteration of the charter, accepted by agents having no authority to represent the company for that purpose; such action under an ineffectual alteration would be wholly unauthorized, and a violation of the contract between the shareholders.¹

§ 298. **Restraining Applications to the Legislature in England.**—The question has been raised, whether or not the individual shareholders or the agents of a corporation can be enjoined by a court of equity from applying for an alteration of the company's charter in their own names.

In England, it has been asserted by high authority that courts of equity have jurisdiction to restrain parties from making applications to Parliament for private legislation, or from opposing similar applications made by others. The jurisdiction has sometimes been placed upon the same ground as that upon which injunctions are granted to restrain parties from proceeding at law; namely, that equity will not permit parties to make an unjust use of the *power* of a tribunal which is unable to take full cognizance of the rights of the parties. Lord Cottenham said: "There is no question whatever about the jurisdiction; a party who comes to oppose a railway bill in Parliament does so solely in respect to his private interest, not as representing any interest of the public, or for the purpose of communicating any information to Parliament. He is not even allowed to be heard as a petitioner against the bill, unless he has a *locus standi* in respect of some property or interest liable to be affected by it if it should pass into a law. This court, therefore, if it sees a proper case connected with private property or interest, has just the same jurisdiction to restrain a party from petitioning against a bill in Parliament, as if he were bringing an action at law or asserting any other right connected with the enjoyment of the property or interest which he claims."²

¹ *Infra*, § 625. *People v. Canal Board*, 55 N. Y. 395; *Greenwood v. Freight Co.*, 105 U. S. 13.

² *Stockton, &c. Ry. Co. v. Leeds, &c. Ry. Co.*, 2 Phill. 670.

§ 299. **In the United States.** — In the United States a different view has been taken. It was held in a New Jersey case, that the legislature in passing its laws, even when they affect private interests, does not act as a court whose power over individuals is greater than its ability to use its power justly, but as the legislative branch of the government, with which the courts cannot interfere. "It is no part of their office to determine in advance what laws ought or ought not to be enacted, or to interfere directly or indirectly with the course of legislation."¹ Again, it is said: "Every citizen has an unquestioned right to petition either branch of the legislature upon any subject of legislation in which he is interested. Every legislator has a right to be informed of the views and wishes of all parties interested in the enactment of a law. This right to perfect freedom of intercourse between the representative and his constituents is not founded upon any constitutional provision or bill of rights, but springs from the very structure of the government."²

§ 300. **The true Principle of the Jurisdiction to restrain Applications to the Legislature.** — The jurisdiction of English courts of chancery to interfere with applications to Parliament is certainly conducive to justice in many cases. The power of Parliament is not limited by any law, and if used without judgment may inflict serious wrong to individuals. It will be denied by no one that a court of equity, acting according to well-established rules, is a tribunal far better adapted to the protection of private interests than a committee of legislators.

But this argument leads too far. If the jurisdiction to interfere with applications to Parliament could be deduced from the fact that Parliament has *power* to violate private rights arbitrarily, and that it may be used by others as a tool or dupe for unjust purposes, a court of equity might at any time enjoin any person from petitioning Parliament merely because some other person in the kingdom might be wronged thereby, — an assumption of supervisory power which could never be tolerated. In *Heathcote v. North Staffordshire Ry.*

¹ *Story v. Jersey City, &c. Plank R. Co.*, 16 N. J. Eq. 13.

² *Ibid.*

Co.,¹ Lord Cottenham said: "The case of Parliament differs widely from that of the courts of common law: the province of the latter is to enforce legal rights, and the object of the injunction is to prevent an inequitable use of such legal rights; but the ordinary province of Parliament in such bills is to abrogate existing rights and to create new rights. To hold, therefore, that no application should be made to Parliament because the object of such application was to interfere with some right or interest of some other party, would be, in effect, to hold that this court should by its injunction deprive the subject of the benefit of parliamentary interference in all such cases. . . . The injunction cannot be granted upon the ground that the act applied for would interfere with existing rights, it being the very object of it to do so."²

§ 301. It will be found that, in all the cases in which the jurisdiction to enjoin petitions to Parliament was asserted, there were special obligations resting upon the parties not to prefer the petitions complained of. In some of the cases the question was whether an application to Parliament, or opposition to an application, should be enjoined because in violation of an express contract; in others, the members of a corporation were attempting to violate their duty to their co-members; and in some cases it was merely an unauthorized use of the corporate name which was enjoined. The correct view seems to be, that the jurisdiction of the courts of equity to interfere with applications to Parliament is merely a branch of the jurisdiction to compel parties to perform their engagements; and that, when parties have voluntarily undertaken not to make an application or not to oppose an application to Parliament, the courts may enforce specific performance of this undertaking by process of injunction.

This view seems to have been entertained by Vice-Chancellor Page-Wood. In a very instructive judgment delivered by him, he held that a contract not to make an application to Parliament was not against public policy, and void, but that

¹ *Heathcote v. North Staffordshire Ry. Co.*, 2 MacN. & G. 100, 110.

² See *Steele v. North Metropolitan Ry. Co.*, L. R. 2 Ch. 240, 241, *per* Lord Chelmsford.

it ought not to be specifically enforced by injunction in the particular case. The question, he said, was, "not whether it may or may not be inconsistent with public policy to allow such an agreement to be entered into at all, but whether this court should interfere for the purpose of specifically performing the agreement by preventing the application to Parliament."¹

PART III.

THE MUTUAL RIGHTS AND OBLIGATIONS OF SHAREHOLDERS WITH RESPECT TO THE CONTRIBUTION OF CAPITAL.

§ 302. **The Contract between the Shareholders cannot be impaired.** — In considering the relation nominally existing between a corporation and its several shareholders, it is necessary to bear in mind that this relationship results entirely from the agreement entered into by the shareholders, for their common benefit, in forming the company. The fact that the rights and obligations created by this agreement must by its terms, be enforced through the medium of the corporate organization, does not prevent the contract of the shareholders from being a mutual contract.²

For this reason it is a rule that no shareholder in a corporation can be discharged by a rescission or cancellation of his contract, except with the unanimous consent of the other members; every shareholder has a right to insist that every other shareholder shall be held to a due performance of his obligations.³ Under the Federal Constitution even a State has no power to impair or alter the contract between the shareholders in a corporation, by legislative enactment; nor can it empower a majority to impair this contract against the will of a single member.⁴

¹ Lancaster & Carlisle Ry. Co. v. Northwestern Ry. Co., 2 K. & J. 293, 302, 309; People v. Canal Board, 55 N. Y. 390, 400.

² *Supra*, § 43 *et seq.*

³ *Supra*, § 109 *et seq.* Chouteau Ins. Co. v. Floyd, 74 Mo. 289.

⁴ *Infra*, § 1027.

It should be observed, however, that, if the validity of a subscription is in dispute, the directors may enter into a *bona fide* compromise with the subscriber, by which his subscription is cancelled.¹ This power must be held to be included in the general discretionary powers conferred upon the directors in the management of the affairs of the association.

§ 303. **Secret Agreements. — Colorable Subscriptions.** — Every person who subscribes for shares in a corporation is entitled to assume that every other person whose name appears on the subscription-books of the company is in reality a subscriber, and subject to the liabilities of membership. Hence, if a subscriber causes his name to be placed upon the stock-books as an apparent holder of shares, he will be estopped from denying that he intended to become a shareholder, and to pay assessments equally with the other members. Any secret agreement between a subscriber for shares and the agents acting on behalf of the company, to the effect that the subscription shall be merely colorable and not binding upon the subscriber, would be a fraud upon all persons subsequently taking shares in the company; such agreement should therefore be denied effect, and the subscription enforced unconditionally.²

The same principle applies where shares are taken in a fictitious name, or in the name of an irresponsible person, for the purpose of swelling the apparent number of shareholders. In this case, the real subscriber or owner should not be allowed to impose upon the other shareholders with impunity,

¹ *New Albany v. Burke*, 11 Wall. 96; *Lord Belhaven's Case*, 3 De G., J. & S. 41; *Putnam v. New Albany*, 4 Biss. 365.

² *Melvin v. Lamar Ins. Co.*, 80 Ill. 446, and cases cited; *Graff v. Pittsburgh, &c. R. R. Co.*, 31 Pa. St. 489; *Robinson v. Pittsburgh, &c. R. R. Co.*, 32 Pa. St. 334; *Muller v. Hanover Junction, &c. R. R. Co.*, 87 Pa. St. 99; *White Mountains R. R. Co. v. Eastman*, 34 N. H.

124; *Connecticut, &c. R. R. Co. v. Bailey*, 24 Vt. 465, 476; *Jewett v. Valley Ry. Co.*, 34 Ohio St. 601; *Blodgett v. Morrill*, 20 Vt. 509; *Minor v. Mechanics' Bank*, 1 Pet. 65; *Mann v. Cooke*, 20 Conn. 178; *Swartwout v. Michigan Air Line R. R. Co.*, 24 Mich. 390; *Pickering v. Templeton*, 2 Mo. App. 424; *Bates v. Lewis*, 3 Ohio St. 459. See *Davidson's Case*, 3 De G. & Sm. 21.

and should be held liable personally under the name he has assumed.¹

§ 304. *Collateral Agreements. — Trusts.* — It is clear that no engagement or relationship between a shareholder and a stranger to the corporation can be allowed to affect the mutual rights and obligations existing between the shareholders by reason of their contract of membership.

In *Holt's Case*,² Robert Holt had signed the deed of settlement of a joint-stock company for the benefit of his brother, who was the covenantee of the deed, and therefore could not sign it himself. A motion having been made to place his name on the list of contributaries, the Vice-Chancellor, Lord Cranworth, said: "I do not entertain a particle of doubt upon this case. What Mr. Robert Holt's reason was for executing the deed of settlement is a matter which it is too late to speculate upon when he has executed it; because, by executing it, he entered into engagements with persons who were wholly ignorant as to the circumstances connected with the shares in respect of which he executed the deed. Every one of those individuals executed the deed on the faith that every other person who executed it should, to the extent of the shares for which he executed it, bear the common liability, and participate in the profits to be derived from the undertaking."

It has accordingly been held that the legal owner of shares in a corporation is liable to the company for calls made upon the shares, though he be a trustee for another person; and the beneficiary cannot be made responsible, for he is not a party to the contract from which the liability for calls arises.³ For the same reason, it follows that only the legal owner of shares is entitled to vote at corporate meetings;⁴ and the *legal* title to dividends belongs to him also.⁵ It is immaterial

¹ See *Cox's Case*, 4 De G., J. & S. L. R. 1 Ch. D. 576; *Sichell's Case*, 53; *Pugh & Sharman's Case*, L. R. L. R. 3 Ch. 119; *King's Case*, L. R. 13 Eq. 566. 6 Ch. 196; *Mitchell's Case*, L. R. 9 Eq. 363.

² *Holt's Case*, 1 Sim. n. s. 389.

³ *Supra*, § 170. See *Bugg's Case*, 2 Dr. & Sm. 452; *Williams's Case*,

⁴ *Infra*, § 463.

⁵ *Supra*, § 170.

for this purpose whether the legal owner be an original subscriber, or a transferee of the shares; for a transfer involves a complete novation of the contract of membership, and the transferee steps into the place of the prior owner.¹

§ 305. **Shareholders have Equal Rights, and must bear Equal Burdens.**—Every share in a corporation is equal to every other share, unless otherwise provided in the charter. Hence it follows that no special privilege or advantage can be given to any member; for every discrimination in favor of a particular member must be made at the expense of the others.

Accordingly, it has been held that the profits of a corporation must be divided evenly among its shareholders, each member being entitled to a dividend in proportion to the number of shares held by him.² For the same reason, it is a rule that every shareholder must contribute a proportionate part of the capital of the company. Thus it was held by the Supreme Court of Georgia that the directors of a corporation had no power to authorize a portion of the shareholders to pay up their shares during the war in depreciated Confederate currency, before regular calls had been made.³

§ 306. **The Issue of Certificates for paid-up Shares.**—A *bona fide* purchaser of certificates for shares issued by the regular agents of a corporation is entitled to rely upon all statements and representations which such certificates usually contain. If the certificates state upon their face that the shares have been fully paid up, the corporation will be estopped from denying the truth of this representation, and cannot charge the purchaser and transferee with further liability, although the shares have never in fact been paid up.⁴ The purchaser

¹ *Supra*, Chapter IV.

² *Jackson v. Newark Plank Road Co.*, 31 N. J. L. 277; *Stoddard v. Shetucket Foundry Co.*, 34 Conn. 542; *Jones v. Terre Haute, &c. R. R. Co.*, 57 N. Y. 196; 29 Barb. 353; *Luling v. Atlantic Mutual Ins. Co.*, 45 Barb. 510; *Ryder v. Alton, &c. R. R. Co.*, 13 Ill. 516; *State v. Baltimore & Ohio R. R. Co.*, 6 Gill,

363; *Atlantic, &c. Tel. Co. v. Commonwealth*, 3 Brewster, 366; *Harrison v. Mexican Ry. Co.*, L. R. 19 Eq. 358; *Coe v. Belfast, &c. Ry. Co.*, Irish Rep. 2 C. L. 112. See *Chaffee v. Rutland R. R. Co.*, 55 Vt. 110, 136.

³ *Macon, &c. R. R. Co. v. Vason*, 57 Ga. 314.

⁴ *Infra*, §§ 585, 816.

would be entitled to enjoy all the rights of membership to the same extent as the other shareholders, whose shares are represented by contributions to the company's capital. It is evident, therefore, that the issue of certificates for paid-up shares to a shareholder whose shares have not in fact been paid up, is unauthorized; it would be a direct infringement of the rights of all existing shareholders in the company, and a source of fraud upon persons giving the company credit, or dealing in its shares thereafter.¹

However, after the capital of a corporation has been reduced by losses, it would not be a wrong against the existing shareholders to issue certificates for paid-up shares on payment of less than their *par* value. Under these circumstances fairness and equality would merely require that the new shares be issued at their *actual* or *market* value. If shares in a corporation could in no case be issued at less than their face value, it would be practically impossible to increase the capital of a corporation by the sale of new shares after the value of its shares had fallen below *par*.² But the augmentation of the capital should not be held out to the world as amounting to the nominal value of the new shares issued, unless this be really the case. It would be a fraud upon those giving credit to the company to represent the fund held out to them as their security at a greater amount than was actually contributed, or promised to be contributed, by the shareholders.

If shares in a corporation have once been fully paid up, and are transferred back to the company, they may be reissued and sold by the agents of the company at their actual or market value.³ Neither creditors nor shareholders would have any right to insist on having the shares disposed of at *par*.

§ 307. **Subscriptions upon Special Terms.**—For the same reason, it follows that the agents of a corporation have no authority to receive particular shareholders upon more favor-

¹ *Sturges v. Stetson*, 1 Biss. 246, 250; *Fosdick v. Sturges*, 1 Biss. 255; *Fisk v. Chicago, &c. R. R. Co.*, 53 Barb. 513. *Supra*, § 286. *Infra*, § 304.

² Compare *Stein v. Howard*, 65 Cal. 616; *Continental Tel. Co. v. Nelson*, 49 N. Y. Super. Ct. 197, 200.

³ *Otter v. Brevoort Petroleum Co.*, 50 Barb. 247.

able terms than the other members. An agreement made with a subscriber for shares, whereby the latter is accorded any special privilege or benefit at the expense of the corporation, is invalid.¹ Thus, a shareholder cannot be received on condition that he shall contribute less than other members, or that his share of the common capital shall not be payable except on a certain contingency,² or that he shall receive a preference in the distribution of profits.³ The contract of subscription must in these cases be treated as wholly void, or it must be enforced without regard to the special agreement.⁴

§ 308. **Those who act as Shareholders are liable as Shareholders.**—Justice to the shareholders in a corporation demands that every person who enjoys the privileges of membership must also bear its burdens. For this reason, it is a general rule that every person who has acted as a shareholder, and enjoyed the privileges of membership, may be held by the company to all the liabilities of membership, although formalities prescribed by the charter have not been observed.⁵

So, where a person is entitled to avoid his contract of membership in a corporation on account of fraud, he must act promptly. He cannot have the benefit of the speculation in which the corporation is engaged if it prove successful, and throw the loss upon the other members in case of failure.⁶

§ 309. **Release from Liability by Forfeiture of Shares.**—The directors of a corporation are often invested by the charter with the power of declaring a forfeiture of shares for non-payment of calls.⁷ This power must be exercised by the directors fairly, and without discrimination against any portion of the company. "It was not intended to supply them with machinery whereby, under the pretence of forfeiture, they should be able to deprive the continuing shareholders

¹ Compare *Henry v. Vermillion*, &c. R. R. Co., 17 Ohio, 187; *New Albany, &c. R. R. Co. v. Fields*, 10 Ind. 190; *Anderson v. New Castle, &c. R. R. Co.*, 12 Ind. 376; *Downie v. White*, 12 Wis. 176; *Bridger's Case*, L. R. 9 Eq. 74; *Melvin v. Lamar Ins. Co.*, 80 Ill. 446.

² *Supra*, § 87.

³ *Infra*, § 443.

⁴ *Supra*, §§ 91, 92.

⁵ *Infra*, § 721.

⁶ *Supra*, § 108.

⁷ *Supra*, § 122 *et seq.*

of the liability of all those for whose joint liability with themselves they had originally stipulated.”¹

Hence a forfeiture for the purpose of escaping liability to creditors is void. A continuing shareholder would be entitled to say: “I became a shareholder, relying on the names of those who were engaged with me in this partnership; I delegated the management to certain directors with defined powers and duties; it was part of the stipulations of the deed of partnership that none of my fellow shareholders should quit the partnership, except by substituting in his place some other person approved by the directors. This was, I thought, a sufficient security to me that, in the event of my being called on by a creditor who, having recovered judgment against the company, should proceed to enforce payment against me, I had solvent partners from whom I might obtain contribution; and now I find that, without any authority from me, you, the directors, have taken on yourselves to enable several of my partners to withdraw from the partnership by a proceeding which I never authorized.”²

For the same reasons, it follows that the directors cannot use the power of forfeiture unfairly against the member whose shares are declared forfeited.³

§ 310. Release from Liability by Transfer of Shares.—A shareholder in an English joint-stock company is entitled to transfer his shares at any time before proceedings to wind up the company have been begun. It is immaterial whether the transferee be solvent or insolvent, and whether the company be in pecuniary difficulties at the time the transfer is made or not.⁴

A different rule prevails in America. Where the contribution of a shareholder is necessary to satisfy creditors in

¹ *Per* Lord Cranworth, in *Stanhope's Case*, L. R. 1 Ch. 169.

² *Per* Lord Cranworth, in *Spackman v. Evans*, L. R. 3 H. L. 171, 186, 190; *Stanhope's Case*, L. R. 1 Ch. 161; 3 De G. & Sm. 198; *Richmond's Case*, 4 K. & J. 305, 324; *Manisty's Case*, 17 *Solicitor's Jour-*

nal, 745; *Gowers's Case*, L. R. 6 Eq. 77; *Dixon v. Evans*, L. R. 5 H. L. 606; *Ex parte Jones*, 27 L. J. Ch. 666; *Hall's Case*, L. R. 5 Ch. 707; *Mills v. Stewart*, 41 N. Y. 386, 390; 62 *Barb.* 444.

³ *Sweny v. Smith*, L. R. 7 Eq. 324.

⁴ *Supra*, § 167.

full, it is well settled that a transfer cannot be made to an insolvent for the purpose of escaping liability.¹ And a transfer would, under these circumstances, be held equally fraudulent as against the other shareholders, upon whom the loss must fall.²

§ 311. **Equitable Rights of Shareholders on winding up the Corporation.**— On the dissolution of a corporation or joint-stock company, it becomes necessary to make a final adjustment of the equitable rights of its shareholders. If the company has earned a surplus, each shareholder is entitled to receive a ratable share of this surplus after the amounts contributed by all the shareholders to the company's capital have been restored to them. Each shareholder who has not fully paid up his shares should be charged with the amount remaining unpaid upon his shares, and then credited with a dividend out of the entire capital and profits of the concern, proportionate to his fractional part of all the outstanding shares. Each shareholder is liable to the corporation for the amount remaining unpaid upon his shares, and this amount may be called in by the company for any proper purpose.³ It is just, therefore, to distribute the profits ratably among all the shareholders, irrespective of the amounts actually paid upon their shares; the relative interests of the shareholders in the corporate concern do not depend upon the amounts which they have contributed in cash.

If the corporation has suffered losses, so that the amount of its capital is impaired, the entire loss must be apportioned among the shareholders in a manner similar to that indicated for the distribution of profits. Each shareholder must, upon final settlement, bear so much of the loss of the whole company as is proportionate to his fractional part in all the outstanding shares.⁴

It is evident, therefore, that if a shareholder is indebted to the corporation, and the latter becomes insolvent, he must contribute the full amount of his debt into the treasury of

¹ *Infra*, § 838.

² *Supra*, § 166.

³ *Supra*, §§ 151, 154.

⁴ Compare *Hartman v. Ins. Co. of Valley of Va.*, 32 Gratt. 242.

the company, and take a dividend with all the other shareholders on the final settlement.¹ On the other hand, if a shareholder has a claim against the corporation as creditor, he must be paid the amount of his claim in full before any distribution of assets can be made among the shareholders.

The above rules apply with equal force where the business of a corporation is closed, and its affairs are wound up, voluntarily or involuntarily, before the company has been dissolved, and in those cases in which the company has ceased to exist in legal contemplation.

§ 312. **Equity of Contribution between Shareholders where the Liability is indefinite.** — In winding up a partnership or a corporation or joint-stock company, whose members are individually liable to creditors to an indefinite extent, it is not necessary to consider special equities which creditors may have against particular shareholders, since they are fully secured in any event; every shareholder is liable to creditors for the full amount of their claims; only the equities existing between the shareholders themselves need, therefore, be considered primarily. However, as between the shareholders themselves, each shareholder is liable only to the extent of his interest in the company, and has a clear right to contribution from the other members. For these reasons, it has been held that, in determining who shall be placed upon the list of contributaries in winding up an ordinary English joint-stock company, the question must be decided between the shareholder and the company, without regard to the claims of creditors.²

§ 313. **No Equity where all must contribute to full Extent of Liability.** — The same principle is applicable where a corporation or *limited* company, whose shareholders are not liable beyond the amount of their shares, is wound up, provided always that the capital of the company be not wholly con-

¹ *Stockton v. Mechanics', &c. Bank*, 32 N. J. Eq. 163, 167.

² See *per* Lord St. Leonards, in *Spackman v. Evans*, L. R. 3 H. L. 171, 197.

The winding up of English joint-stock companies under the Compa-

nies Acts has been treated of very fully in Lindley on Partnership (4th ed., pp. 1223 to 1474). A large fund of cases may be found here, in which the equities existing between the shareholders of a company are illustrated.

sumed by losses. Each shareholder is therefore entitled to insist that the loss be equitably apportioned.¹

But after a company of this description has become wholly bankrupt, so that the full liability of every member must necessarily be exhausted in order to pay all outstanding debts, only the rights of creditors need be considered. In this case the shareholders are no longer interested in securing an equal apportionment, and there are no equities to be adjusted between the company and individual members, since every shareholder must, in any event, contribute to the full extent of his liability in order to satisfy creditors.

§ 314. **Equity where the Liability is not fully exhausted.**— If it is not necessary to exhaust the entire liability of all the shareholders to creditors, any shareholder who has contributed more than his ratable share in payment of the debts of the company is entitled to recover contribution from the other shareholders, until the whole amount paid has been equitably apportioned between them. This rule applies equally where the payment is made on account of the undertaking of the shareholders to contribute the amount of their shares to the working capital of the company, and where it is made by reason of an individual liability, imposed for the security of creditors alone.

Thus, in a suit brought to enforce the individual liability of shareholders of a corporation, under a statute providing that "all stockholders shall be held liable to an amount equal to their stock subscribed, for the purpose of securing the creditors of such company," the Supreme Court of Ohio said: "The right of contribution grows out of the organic relation existing among the stockholders. As between them

¹ In *Chandler v. Brown*, 77 Ill. 334, the Supreme Court of Illinois held that a decree closing up the affairs of a corporation and appointing a receiver, and giving him discretionary power to compromise with stockholders with regard to the payment of their subscriptions, was erroneous. Justice Scholfeld said: "Each stockholder had a vested right in the contract for subscription of every other stockholder, and we think it beyond the power of a court of equity to invest any person with a discretionary right to release it; at all events, it cannot be done by a decree to which the stockholders are not parties."

and the creditors, each stockholder is severally liable to all the creditors; as between themselves, each stockholder is bound to pay in proportion to his stock."¹

§ 315. **Equity of Contribution in winding up a Corporation.**—Upon the same principle, it follows that, in winding up an insolvent corporation whose shareholders are liable either for unpaid capital or to the creditors directly, all the shareholders who can be reached should be brought before the court and assessed ratably.² Every shareholder may undoubtedly be charged to the full extent of his liability, if necessary to satisfy creditors. But if all the shareholders who are liable have not been brought before the court, those who are defendants ought not to be charged with the liability which should fall upon those who are absent, unless it be shown that the latter are either insolvent, or are outside of the jurisdiction of the court.³

This rule, however, applies only where the corporation is actually in process of liquidation, or where the shareholders are entitled to have the company wound up. If the company is still a going concern, an ordinary creditors' bill may be brought against any shareholder who has not paid up his shares; and suit may afterwards be maintained by the shareholder against the company in its corporate capacity, to recover the amount which he has been compelled to pay.

And even though the corporation be insolvent, a creditor

¹ *Umsted v. Buskirk*, 17 Ohio St. 113, 118; *Matthews v. Albert*, 24 Md. 527; *Stewart v. Lay*, 45 Iowa, 604, 614; *Hadley v. Russell*, 40 N. H. 109, 112; *Erickson v. Nesmith*, 46 N. H. 371; *Masters v. Rossie Mining Co.*, 2 Sandf. Ch. 301, 305; *Aspinwall v. Torrance*, 1 Lans. 381; *Farrow v. Bivings*, 13 Rich. Eq. 25; *Gray v. Coffin*, 9 Cush. 192; *Middletown Bank v. Magill*, 5 Conn. 61, *per* Hosmer, C. J.; *Brinham v. Wellersburg Coal Co.*, 47 Pa. St. 49. *Infra*, §§ 846, 874.

Concerning the right of contribution and indemnity in case of

partnerships and joint-stock companies, see *Lindley on Partnership* (4th ed.), 753, 1442. Compare *O'Reilly v. Bard*, 105 Pa. St. 569; *Ray v. Powers*, 134 Mass. 22.

² See *Adler v. Milwaukee, &c. Brick Co.*, 13 Wis. 57, 63; *Mann v. Pentz*, 3 N. Y. 415; *Vick v. Lane*, 56 Miss. 681.

³ See *Wood v. Dummer*, 3 Mason, 308, 321; *Marsh v. Burroughs*, 1 Woods, 463. Compare *Erickson v. Nesmith*, 46 N. H. 371; *Vick v. Lane*, 56 Miss. 681; *Bronson v. Wilmington, &c. Life Ins. Co.*, 85 N. C. 411.

may proceed against a portion of the shareholders to enforce their liability for unpaid capital, without making the other shareholders parties. When a corporation becomes insolvent, it is the duty of the shareholders to wind it up,—to collect the unpaid capital by assessment through the regular agents, and distribute it amongst the creditors. If the shareholders and their agents neglect to perform this duty, they cannot compel a creditor to go to the trouble and expense of performing it for them.¹ Creditors may therefore proceed against the shareholders without regard to the equities existing between them. Those shareholders who feel aggrieved thereby must themselves take the proper steps to have the company wound up, and their rights adjusted, either by having a receiver appointed, or by filing a cross-bill and bringing in the other shareholders for contribution.

Accordingly, in *Hatch v. Dana*,² a creditors' bill, brought against a portion of the stockholders of an insolvent corporation, was sustained by the Supreme Court of the United States. The bill was not a bill to wind up the company. It was brought simply to obtain payment of a debt out of the unpaid stock liability of the defendants. The court said: "We hold that the complainant was under no obligation to make all the shareholders of the bank defendants in his bill. It was not his duty to marshal the assets of the bank, or to adjust the equities between the corporators. In all that, he had no interest. The appellants may have had such an interest, and, if so, it was quite in their power to secure its protection. They might have moved for a receiver, or they might have filed a cross-bill, obtained a discovery of the other stockholders, brought them in, and enforced contribution from all who had not paid their stock subscriptions. Their equitable right to contribution is not yet lost."³

¹ This does not apply where the shareholders are liable to creditors directly. The individual liability of the shareholders is not *capital*, and cannot be collected by assessment. *per* Justice Strong. See also *Ogilvie v. Knox Ins. Co.*, 22 How. 380; *Marsh v. Burroughs*, 1 Woods, 463; *Bartlett v. Drew*, 57 N. Y. 587. Compare *Vick v. Lane*, 56 Miss. 681; *Phoenix Warehousing Co. v. Badger*,

² 101 U. S. 205.

³ *Hatch v. Dana*, 101 U. S. 214, 67 N. Y. 294. See *infra*, § 844.

CHAPTER VI.

THE CONSTRUCTION OF CHARTERS.

PART I.

§ 316. **The General Rule governing the Construction of Charters in the United States.**—The charter of a corporation serves a twofold purpose: it operates as a law conferring upon the incorporators the right or franchise of acting in a corporate capacity, and furthermore it contains the terms of the fundamental agreement between the incorporators themselves.¹

There is no reason why a charter should be construed differently from other written instruments. The object should be to discover the intention of the parties, and it would be absurd to attempt to ascertain the intention of the parties by the application of any technical or arbitrary rule.

Those who become members of a corporation for purposes of pecuniary profit evidently intend that the object of their company shall be to prosecute the enterprise expressly set forth in their charter or articles of association; and they evidently do not intend to join in any speculation which is not in pursuance of the purposes thus indicated. It is clear, also, that the intention of the legislature in incorporating a company is to enable the company to act in a corporate capacity, so far, and so far only, as is necessary in order to carry on the business for which the company was formed.

It follows, therefore, that every act of a corporation which is not affirmatively authorized by its charter involves both

¹ A charter may also contain a contract between the incorporators and the State. See *infra*, Chapter XV.

an unauthorized exercise of corporate power and a departure from the original agreement between the members of the company.

This rule of construction is well settled throughout the United States. In *Thomas v. Railroad Co.*,¹ the Supreme Court of the United States said: "We take the general doctrine to be in this country, though there may be exceptional cases and some authorities to the contrary, that the powers of corporations organized under legislative statutes are such, and such only, as those statutes confer. Conceding the rule applicable to all statutes, that what is fairly implied is as much granted as what is expressed, it remains that the charter of a corporation is the measure of its powers, and that the enumeration of these powers implies the exclusion of all others."²

§ 317. **The General Rule in England.**—The practical result of the English authorities relating to this point is necessarily the same as that of the American authorities. A different rule would have been intolerable. But it was found necessary by some of the English judges to reach this result by a highly artificial method of reasoning.

It was said that an act of Parliament incorporating an association must be held to confer authority upon the corporation to do all those acts which are lawful to individuals

¹ 101 U. S. 71.

² *Per* Mr. Justice Miller in *Thomas v. Railroad Co.*, 101 U. S. 82; *Perrine v. Chesapeake, &c. Canal Co.*, 9 How. 184; *Dartmouth College v. Woodward*, 4 Wheat. 636; *Vandall v. South San Francisco Dock Co.*, 40 Cal. 83; *Bellmeyer v. Independent District, &c.*, 44 Iowa, 564; *Weckler v. First National Bank*, 42 Md. 581; *Matthews v. Skinker*, 62 Mo. 329; *Metropolitan Bank v. Godfrey*, 23 Ill. 579; *Caldwell v. City of Alton*, 33 Ill. 416; *Pullan v. Cincinnati, &c. R. R. Co.*, 4 Biss. 35; *Overmyer v. Williams*, 15 Ohio, 31;

Straus v. Eagle Ins. Co., 5 Ohio St. 59; *Commonwealth v. Erie, &c. R. R. Co.*, 27 Pa. St. 339; *City Council v. Montgomery, &c. Plank Road Co.*, 31 Ala. 76; *New London v. Brainard*, 22 Conn. 552; *Brady v. The Mayor*, 20 N. Y. 312; *Brooklyn Gravel Road Co. v. Slaughter*, 33 Ind. 185.

There is no doctrine of the law of corporations which has been more often affirmed by the American judges than that stated in the text. It has been expressed, or at least assumed, to be the law, in most of the cases bearing upon the construction of charters.

and are not expressly or impliedly prohibited *by the act*; and that this rule of construction rests upon the authority of a resolution in Sutton's Hospital Case, reported in 10 Coke's Reports, 30 b.¹

The principle upon which this doctrine is based is not very clear. Both in England and in America it is conceded that corporate powers cannot be exercised lawfully until authority has been granted by law; all persons are *forbidden* by the common law to exercise any corporate powers, except under authority conferred by statute or by royal charter. Not one of the English judges has ever intimated an opinion that the intention of Parliament may be disregarded in construing its grants of corporate franchises. To say, then, that whenever Parliament undertakes to grant the right of forming a corporation, and of acting in a corporate capacity for any purpose, immediately it must be construed as granting whatever it does not prohibit, is certainly an arbitrary method of construction. It is a construction which has never been applied in other classes of grants or contracts, and is evidently contrary to the intentions of the legislature and the shareholders forming the company.

Mr. Pollock, in discussing the contrary doctrine, which is the rule in America, says: "It is adopted by some of the best English writers;² and, in America, Kent stated it (long before the subject had obtained its present development in England) as the modern and even the obvious doctrine. It also seems to have been taken for granted by those who framed the modern statutes defining the powers of incorporated companies; which, if the opposite view be correct, are redundant in permission and defective in prohibition."³

¹ See Pollock on Contracts, 88; *per* Blackburn, J., in *Riche v. Ashbury Ry., &c. Co.*, L. R. 9 Exch. 263, 264; *Atty.-Gen. v. Great Eastern Ry. Co.*, L. R. 5 App. Cas. 481. Whatever the resolution in Sutton's Hospital Case may have meant, it is certain that at that time corporations like the modern joint-stock companies were unknown.

² Citing Lindley on Partnership, 263; Leake on Contracts, 258.

³ Pollock on Contracts, 89. See *per* Bramwell, L. J., in *Atty.-Gen. v. Great Eastern Ry. Co.*, L. R. 11 Ch. D. 501.

The effect of the doctrine above criticised has, however, been counteracted by another arbitrary rule of construction, which also appears to be peculiar to the English courts. For it must be held in England, that, when the legislature charters a corporation for a particular purpose, and with special powers, (and corporations are never chartered otherwise,) then the legislature intends to prohibit the company so formed from exercising any powers except for the purposes for which it was chartered.¹

The practical result is therefore as follows. In England, a corporation has authority to do any act which is expressly or impliedly authorized by its charter, and whatever acts are not so authorized are impliedly prohibited by the act creating the corporation. In America, also, a corporation has authority to do any act which is expressly or impliedly authorized by its charter, and whatever acts are not so authorized are prohibited by the common law.²

§ 318. **Construction of the Articles of Association of Companies organized under General Laws.** — At the present day corporations are usually formed by the adoption of articles of association and the subscription of capital, in pursuance of general incorporation laws enacted by the legislature. The

¹ *Shrewsbury, &c. Ry. Co. v. Northwestern Ry. Co.*, 6 H. L. C. 113; *Eastern Counties Ry. Co. v. Hawkes*, 5 H. L. C. 348, *per* Lord Cranworth; *National Manure Co. v. Donald*, 28 L. J. Ex. 188, *per* Pollock, C. B.; *Shrewsbury, &c. Ry. Co. v. London, &c. Ry. Co.*, 22 L. J. Ch. 682; *Atty.-Gen. v. Great Northern Ry. Co.*, 1 Dr. & Sm. 154.

² In *Shrewsbury, &c. Ry. Co. v. Northwestern Ry. Co.*, 6 H. L. C. 137, 138, Lord Cranworth, L. C., quoting the words of Mr. Baron Parke, said: "Where a corporation is created by act of Parliament for particular purposes with special powers, their deed, though under

their corporate seal, does not bind them, if it appears by the express provisions of the statute creating the corporation, or by necessary or reasonable inference from its enactment, that the deed is *ultra vires*, that is, that the legislature meant that the deed should not be made.' I think this is the more correct way of enunciating the doctrine, though practically it makes very little difference whether we say that the railway company has no authority given to it by its incorporation to enter into contracts as to matters not connected with its corporate duties, or that it is impliedly prohibited from so doing, because by necessary inference the legislature

articles of association of a company thus organized, taken in connection with the laws under which the organization takes place, form the constitution of the association, and answer the same purposes as a special charter. They contain the terms of the agreement of association between the shareholders, and indicate the character and extent of the business in which the company shall engage; they also contain a grant from the State, to those organizing under the law, of the franchise, or right of forming a corporation and attaining the purposes agreed upon.¹

The same rules of construction apply to articles of incorporation adopted pursuant to general laws, as to charters of incorporation granted by special acts of the legislature. In considering the extent of the rights or franchises of a corporation, and the powers of its agents, substantially the same implications must be made, whether the company was incorporated under a general law or by special act. The word "charter," as used in this chapter, must be taken to mean the instrument or instruments containing the fundamental agreement between the members of the association and the franchises granted by the State.

The articles of association of an unincorporated joint-stock company serve substantially the same purposes, and are subject to the same rules of construction, as the articles of a corporation in the technical sense of the term.²

§ 319. **Construction of Act legalizing an existing Corporation.** — Where the legislature, by statute, recognizes and acquiesces in the existence of a corporation which was formed by the corporators without the proper authority, it thereby invests the association with the right of continuing to act in a corporate capacity for the purposes and in the manner that it publicly assumed to act. And if rights or franchises are conferred upon an association claiming to be incorporated, it thereby becomes authorized to exercise the powers expressly

must be considered to have intended that no such contracts should be entered into."

¹ Bergman v. St. Paul, &c. Build-

ing Ass., 29 Minn. 275, 282; Grangers' Life, &c. Ins. Co. v. Kamper, 73 Ala. 325, 342.

² Bray v. Farwell, 81 N. Y. 600.

conferred, and such others as the legislature appears to have imputed to it.¹

§ 320. What may be implied in construing the Charter of a Trading Corporation. — General Rule. — A trading corporation is in many respects like a trading copartnership. It is an association formed for the purpose of carrying on a particular business or trade, for the pecuniary profit of its individual members.

Charters of incorporation frequently prescribe only the main objects of the companies formed under them. Authority to use the means necessary to attain these objects must, therefore, be supplied by implication.

It is apparent that a business corporation cannot carry on its business successfully, unless it is able to act substantially in the same manner as an individual or a copartnership would act under similar circumstances; and it is but reasonable to suppose that, when the legislature incorporates a company for the purpose of carrying on a particular business, the intention is that the company shall carry on the business in the usual manner, and that it shall have authority to exercise all powers necessary to enable it to accomplish this purpose.

The rule of construction is settled accordingly. It is held that a corporation has implied authority to prosecute its legitimate business in the same manner as an individual or an unincorporated association engaged in a similar enterprise; but any act which is prohibited by the charter, or not within the purposes for which the company was formed, remains unauthorized.² This rule applies equally to corporations

¹ *Supra*, § 20.

² In *Barry v. Merchants' Exchange Co.*, 1 Sandf. Ch. 289, Vice-Chancellor Sandford said: "A corporation, in order to attain its legitimate objects, may deal precisely as an individual may who seeks to accomplish the same ends." See also *White Water Valley Canal Co. v. Vallette*, 21 How. 424; *McKiernan v. Lenzen*, 56 Cal. 61;

Thompson v. Lambert, 44 Iowa, 239; *Old Colony R. R. Co. v. Evans*, 6 Gray, 38; *Clark v. Farrington*, 11 Wis. 333; *Blunt v. Walker*, Id. 349; *Willmarth v. Crawford*, 10 Wend. 342; *Union Bank v. Jacobs*, 6 Humph. 525; *Ohio Life Ins. Co. v. Merchants' Ins. Co.*, 11 Humph. 22.

The same rule applies in England. See *Bostock v. North Staffordshire Ry. Co.* 4 El. & Bl. 819;

formed under general incorporation laws, and to corporations formed under special charters.¹

The rule of construction has frequently been stated by the American judges more narrowly than by the English judges, but it will be found upon an examination of the actual decisions that charters are construed with at least as much liberality in the United States as in England.

§ 321. **Construction of Express Limitations. — Prohibitions from entering upon a Course of Dealing.** — Authority to enter into a contract which is in violation of an express prohibition of the charter of a corporation, or a general rule of law, can never be implied. But the provisions of a law or charter should always be construed in such a manner as to attain their purposes without interfering unnecessarily with the usages of trade.

Accordingly, it has been held in various cases that a prohibition from engaging in a particular course of dealing does not include a prohibition from doing exceptional acts, although the repetition of these acts would constitute the prohibited course of dealing. A prohibition from dealing in a certain kind of property does not take away the right of a corporation to acquire such property for use or consumption by the company, or in satisfaction of a valid debt, or by way of security.² A law forbidding certain corporations from

Ex parte Birmingham Banking Co., L. R. 6 Ch. 83; *Scottish, &c. Ry. Co. v. Stewart*, 3 Macq. 382, 415. A similar principle of construction must be applied to the constitution of a club or other society. *Ingham v. Reform Club*, 12 Phila. 264.

¹ In *Wendel v. State*, 62 Wis. 304, Taylor, J., said: "It is not necessary that the articles of association shall designate with particularity all the powers which it may exercise when duly incorporated. It is sufficient if they designate in general terms the purposes for which the corporation is organized; and when organized, such corporation

may exercise all the powers which are conferred upon such corporations by statute, and probably all such powers as are usually exercised by similar corporations, and which are necessary to accomplish the purposes of such corporation, not in conflict with the laws of the State." See *Richardson v. Massachusetts Charitable, &c. Ass.*, 131 Mass. 174.

² *Fleckner v. Bank of U. S.* 8 Wheat. 351; *First National Bank v. National Exchange Bank*, 92 U. S. 128; *Western Cottage Organ Co. v. Reddish*, 51 Iowa, 55; *Clark v. Farrington*, 11 Wis. 306; *Blunt v. Walker*, 11 Wis. 334; *Ingraham*

issuing negotiable paper as a circulating medium, or from dealing in commercial paper, does not affect the implied right of issuing and receiving negotiable paper in ordinary trading transactions, or for any purpose incidental to the legitimate business for which the corporation was formed.¹

In *Mechanics' Bank v. Bank of Columbia*,² it was held that a section in the charter of a bank, providing "that all bills, bonds, notes, and every other contract or engagement on behalf of the corporation, shall be signed by the president and countersigned by the cashier," was not intended to extend to contracts implied by law, or to transactions of a common occurrence, such as drawing checks and issuing certificates of deposit.

§ 322. An express provision in the charter of a corporation authorizing it to act in a certain manner, in some instances, implies a prohibition from acting in any other manner. Thus, it has been decided that a provision in the charter of a safe-deposit company, expressly enumerating the kinds of securities in which the corporation may invest its capital and the funds deposited with it, by implication, prohibits the

v. Speed, 30 Miss. 410; *Bates v. Bank of Alabama*, 2 Ala. 465; *Graham v. Hendricks*, 22 La. Ann. 523; *Sackett's Harbor Bank v. Lewis County Bank*, 11 Barb. 213; *Steam Nav. Co. v. Weed*, 17 Barb. 383. See also *Cooper Manuf. Co. v. Ferguson*, 113 U. S. 727.

¹ *Blair v. Perpetual Ins. Co.*, 10 Mo. 561; *Buckley v. Briggs*, 30 Mo. 452; *Smith v. Eureka Flour Mills Co.*, 6 Cal. 1; *Atty.-Gen. v. Life & Fire Ins. Co.*, 9 Paige, 470; *Partridge v. Badger*, 25 Barb. 146; *Potter v. Bank of Ithaca*, 7 Hill, 530; *Mumford v. American L. Ins., &c. Co.*, 4 N. Y. 463; *White's Bank v. Toledo, &c. Ins. Co.*, 12 Ohio St. 601; *Western Cottage Organ Co. v. Reddish*, 51 Iowa, 55.

On the other hand, an express authority to buy and sell negotiable

paper is not sufficient to enable a corporation to engage in the business of banking, unless it be chartered to carry on a business of that character. *Sumner v. Marcy*, 3 Woodb. & M. 112, 113; *Duncan v. Maryland Sav. Inst.*, 10 G. & J. 299; *Re Ohio Life Ins., &c. Co.*, 9 Ohio, 291; *State v. Granville, &c. Soc.*, 11 Ohio, 1.

A prohibition from engaging in banking includes the discounting of notes or bills of exchange as a regular business. *New York, &c. Ins. Co. v. Ely*, 5 Conn. 560, 574; *New York, &c. Ins. Co. v. Sturges*, 2 Cow. 664. See *Pratt v. Eaton*, 18 Hun, 293; *Taylor v. Bruen*, 2 Barb. Ch. 301. Compare *People v. Loewenthal*, 93 Ill. 191.

² *Mechanics' Bank v. Bank of Columbia*, 5 Wheat. 326.

company from lending money upon any other securities than those named.¹ But this method of construction cannot, as a rule, be applied to the charters of ordinary business corporations. The charters of such companies often contain provisions indicating in detail some of the kinds of transactions in which the companies may engage. These provisions are not designed to negative the existence of powers which might otherwise be implied; their object is to confer additional powers, or to remove possible doubts as to powers which may be implied. In many instances they are mere surplusage. It would defeat the object of provisions of this description to treat them as restricting the powers which would ordinarily be accorded to the corporation by implication.

§ 323. **Grants of Special Franchises.** — The rule of construction stated in the preceding section has no application to a grant of special privileges in derogation of common right, or of an exemption from the operation of general laws governing other persons. It should always be presumed, that the legislature does not intend to confer franchises of this character, unless a contrary intention be expressed in unambiguous terms.

In *Fertilizing Co. v. Hyde Park*,² Mr. Justice Swayne said: "The rule of construction in this class of cases is, that it shall be most strongly against the corporation. Every reasonable doubt is to be resolved adversely. Nothing is to be taken as conceded but what is given in unmistakable terms, or by an implication equally clear. The affirmative must be shown. Silence is negation, and doubt is fatal to the claim. This doctrine is vital to the public welfare. It is axiomatic in the jurisprudence of this court."

¹ *Pratt v. Short*, 79 N. Y. 437. See also *New York, &c. Insurance Co. v. Ely*, 2 Cowen, 678. *Francisco*, 52 Cal. 112; *Bowling Green, &c. R. R. Co. v. Warren County Court*, 10 Bush, 711; *Bradley v. New York, &c. R. R. Co.*, 21 Conn. 294; *Talmadge v. North American Coal, &c. Co.*, 3 Head, 337; *Thompson v. Androscoggin, &c. Improvement Co.*, 58 N. H. 108.

² 97 U. S. 659, 666. See also *Charles River Bridge Co. v. Warren Bridge Co.*, 11 Pet. 420; *Rice v. Railroad Co.*, 1 Black, 358; *New York, &c. R. R. Co. v. Kip*, 46 N. Y. 546; *Spring Valley W. W. Co. v. San*

The distinction here pointed out is not an arbitrary one, but is founded on evident reasons.¹ Accordingly, it has been held, that a law or charter granting a right to exercise the power of eminent domain,² or to create a nuisance,³ or to hold a lottery, or to do any other act not lawful to the members of the community generally, should be strictly construed.⁴ Every presumption will be made against the existence of an exemption from taxation,⁵ or from the general laws relating to usury;⁶ or of a right to a monopoly or special privilege, to the exclusion of others, or at the public expense.⁷

§ 324. **Presumptions as to the Validity of Corporate Acts.** — It has been stated frequently, both in England and in America, that an act performed by a corporation should be pre-

¹ See *infra*, § 1032 *et seq.*

² *New York, &c. R. R. Co. v. Kip*, 46 N. Y. 546; *Hannibal Bridge Co. v. Schaubacker*, 49 Mo. 555; *East St. Louis v. St. John*, 47 Ill. 463; *State v. Jersey City*, 1 Dutch. 309; *Van Wickle v. Camden, &c. R. R. Co.*, 2 Green (14 N. J. Law), 162; *Eward v. Lawrenceburgh, &c. R. R. Co.*, 7 Ind. 711; *Moorhead v. Little Miami R. R. Co.*, 17 Ohio, 340; *Blakemore v. Glamorganshire Canal Co.*, 1 Myl. & K. 154; *Webb v. Manchester, &c. Ry. Co.*, 4 Myl. & C. 116.

³ *Fertilizing Co. v. Hyde Park*, 97 U. S. 659; *Babcock v. New Jersey Stock Yard Co.*, 20 N. J. Eq. 296; *Newark Plank R. Co. v. Elmer*, 1 Stockt. 754; *Jersey City v. Morris Canal, &c. Co.*, 1 Beas. 547; *Allegheny v. Ohio, &c. R. R. Co.*, 26 Pa. St. 355; *Commonwealth v. Erie, &c. R. R. Co.*, 27 Pa. St. 339; *Wales v. Stetson*, 2 Mass. 146. Compare *Justices, &c. v. Griffin, &c. Plank Road Co.*, 9 Ga. 475, and *Atty.-Gen. v. Stevens*, Saxt. (N. J.) 369.

⁴ *State v. Krebs*, 64 N. C. 604; *Beaty v. Knowler*, 4 Pet. 152; *Mayor v. Chorley W. W. Co.*, 2 De G., M. & G. 852.

⁵ *The Delaware R. R. Tax Case*, 18 Wall. 206; *Fertilizing Co. v. Hyde Park*, 97 U. S. 666, and cases cited.

⁶ *Tyng v. Commercial Warehouse Co.*, 58 N. Y. 308; *Johnson v. Griffin Banking, &c. Co.*, 55 Ga. 691. See *Reiser v. William Tell, &c. Ass.*, 39 Pa. St. 137; *Houser v. Hermann Building Ass.*, 41 Pa. St. 478; and compare *Franklin Building Ass. v. Marsh*, 29 N. J. Law, 225.

⁷ *Richmond, &c. R. R. Co. v. Louisa R. R. Co.*, 13 How. 71; *Charles River Bridge Co. v. Warren Bridge Co.*, 11 Pet. 420; *Providence Bank v. Billings*, 4 Pet. 514; *Ruggles v. Illinois*, 108 U. S. 526; *Gaines v. Coates*, 51 Miss. 335; *De Lancey v. Insurance Co.*, 52 N. H. 581; *Cayuga Bridge Co. v. Magee*, 2 Paige, 116; *Mohawk Bridge Co. v. Utica, &c. R. R. Co.*, 6 Paige, 554; *McCartee v. Orphan Asylum Soc.*, 9 Cow. 437; *Bowen v. Lease*, 5 Hill, 221; *Hooker v. New Haven, &c. Co.*, 15 Conn. 312; *Bennett's Branch Imp. Co.'s Appeal*, 65 Pa. St. 242; *Pratt v. Atlantic, &c. R. R. Co.*, 42 Me. 579; *Isham v. Bennington Iron Co.*, 19 Vt. 248.

sumed to have been performed under authority of its charter until the contrary shall have been shown; that an act is *prima facie intra vires*, and that the burden of proving that it is *extra vires* rests upon the party claiming that the company has violated its charter.¹ These statements have no definite meaning independently of the connection in which they are used, and their vagueness does not recommend them to general use.

It is well settled that, in determining the validity of an act performed by an agent of a corporation, it may often be presumed that the agent acted within the scope of his authority; if the act in question would be authorized under ordinary circumstances, a person claiming that it was not authorized must show why it was not authorized.² This, however, is merely a rule of the law of agency, and not, properly speaking, a rule governing the construction of charters.

There can be no need of raising any presumption as to the extent of the powers of a corporation, where its charter has been proven or is judicially known to the court. The charter of a corporation contains the terms upon which the shareholders have associated, and gives the measure of the powers which the company and its agents may lawfully exercise. It has been pointed out that charters should be construed liberally, like other instruments of a similar character. They are usually expressed in very general terms, and do not provide all the details necessary to carry out the purposes of the companies formed under them.³

¹ See cases in the following note.

² *Express Co. v. Railroad Co.*, 99 U. S. 199; *Lorillard v. Clyde*, 86 N. Y. 384; *Yates v. Van De Bogert*, 56 N. Y. 526; *De Groff v. American Linen Thread Co.*, 21 N. Y. 124; *Chataouque Co. Bank v. Risley*, 19 N. Y. 369; *Farmers' L. & T. Co. v. Perry*, 3 Sandf. Ch. 339; *Same v. Clowes*, 3 N. Y. 470; *Same v. Curtis*, 7 N. Y. 466; *N. Y., &c. Ins. Co. v. Sturges*, 2 Cow. 664; *Safford v. Wycokoff*, 4 Hill, 442; *Ex parte Peru*

Iron Co., 7 Cow. 540; *McFarlan v. Triton Ins. Co.*, 4 Denio, 392; *Dockery v. Miller*, 9 Humph. 731; *Mitchell v. Rome R. R. Co.*, 17 Ga. 574; *Dana v. Bank of St. Paul*, 4 Minn. 385; *Morris, &c. R. R. Co. v. Sussex R. R. Co.*, 20 N. J. Eq. 542; *Blake v. Holley*, 14 Ind. 383; *Middlesex, &c. Co. v. Davis*, 3 Metc. (Mass.) 133. See *Oxford Iron Co. v. Spradley*, 46 Ala. 98, and cases cited. *Infra*, § 577 *et seq.*

³ *Supra*, § 320.

Where the court has no judicial knowledge of the charter of a corporation, as in case of a foreign corporation or a corporation chartered by a private law, a party upon whom rests the burden of proving the validity or invalidity of the company's acts must bring its charter to the knowledge of the court; but where the existence of a company of a certain general description is shown, it may be presumed to have such powers as are usually incident to companies of a similar character.¹

§ 325. **Powers incidental to all Corporations.** — Those powers and characteristics which are essential in order to bring an association within the definition of the word "corporation" may be said to be incidental to all corporations aggregate. The word "corporation" has, however, been applied to associations so widely dissimilar in their character and constitution, that it is impossible to name any one power or quality which is inseparably incidental to all corporations.² It is not even true, that all corporations aggregate are voluntary associations; the term "corporation" applies to government institutions, like municipalities, and collective bodies of persons, who are not bound together by any mutual agreement or relationship.³ The most that can be said is, that all corporations aggregate are bodies of persons viewed in a collective capacity.

According to Blackstone,⁴ the following five powers are inseparably incident to every corporation *aggregate* : —

1. To have perpetual succession.
2. To sue or be sued, implead or be impleaded, grant or receive, by its corporate name, and do all other acts as natural persons may.
3. To purchase lands, and hold them, for the benefit of themselves and their successors.
4. To have a common seal.
5. To make by-laws or private statutes for the better government of the corporation.

¹ Compare *Charleston, &c. Turnpike Co. v. Willey*, 16 Ind. 34.

² *Supra*, §§ 2-6.

³ *Supra*, §§ 3, 6.

⁴ 1 Bl. Com. 475, 476. See also *Kyd on Corp.* 69.

But this statement is not strictly accurate. It is true, that the five powers which have been enumerated belong to most corporations aggregate, and an association possessing these powers would undoubtedly be termed a corporation ;¹ but it does not follow that these powers belong to *all* corporations aggregate. An association or collection of persons may properly be called a corporation, although not possessing any one of the five powers which have been enumerated.

§ 326. **What Acts a Corporation may do.** — The general rule has been stated to be, that a corporation may prosecute its legitimate business in the same manner as an individual or copartnership engaged in a similar enterprise.² In the following sections cases will be cited, showing in detail that corporations have implied authority to acquire property and dispose of it, to enter into contracts, defend their rights, and generally do all acts which unincorporated companies or individuals may do, in attaining their authorized purposes.

The authorities referred to in the second and third parts of this chapter relate to the management of the internal affairs of corporations, and to the general policy to be pursued by corporations in their business enterprises.

§ 327. **The Implied Right of acquiring Property.** — A corporation has implied authority, in the absence of a prohibition in its charter, to acquire and hold any property, whether real or personal, which may be required in carrying on the business for which the company was formed. This implied authority extends not merely to the acquisition of such property as is absolutely necessary in carrying on the company's business ; a corporation may acquire and hold whatever prop-

¹ In *Liverpool Ins. Co. v. Massachusetts*, 10 Wall. 566, the Supreme Court of the United States held that a joint-stock association formed in England was a corporation within the meaning of laws in force in the United States, by reason of the following attributes: 1. It had a distinctive and artificial name, by which it could make contracts ; 2. It could

sue and be sued in one name, and be bound by the judgment rendered in such suit ; 3. The shares of its members were transferable, so as to secure a perpetual succession of membership ; and 4. It could sue its individual shareholders, and be sued by them, as a distinct entity. See *supra*, § 18.

² *Supra*, § 320.

erty is reasonably useful and convenient in attaining its legitimate ends.¹

The implied right of a corporation to acquire and hold property is merely incidental to the special business or enterprise for which the company was formed. A corporation has no right to purchase land or any other property for any purpose which is outside of the business indicated by its charter.² It is to be observed, however, that a purchase of property which would be wholly unauthorized under ordinary circumstances may become proper upon the happening of peculiar events, the rule being that a corporation may do all such acts in the management of its business as an individual would ordinarily do under similar circumstances.³

§ 328. *Statutes of Mortmain.*—The implied right of corporations to acquire and hold property for authorized purposes has, in many cases, been restrained within definite limits, either by general statutes or by the acts under which the companies were formed. Thus, the English statutes of mortmain were enacted at an early day, to prevent the accumulation of real estate in ecclesiastical corporations; and afterwards their operation was extended to lay corporations also.⁴ These statutes seem never to have been in force in the United States.⁵ But provisions of a similar character

¹ 1 Bl. Com. 475, 478; 2 Kent's Com. 227; *Blanchard's Gun Stock, &c. Factory v. Warner*, 1 Blatchf. C. Ct. 258; *Page v. Heineberg*, 40 Vt. 81; *Old Colony R. R. Co. v. Evans*, 6 Gray, 38; *Spear v. Crawford*, 14 Wend. 23; *Thompson v. Waters*, 25 Mich. 222, 227; *Moss v. Averell*, 10 N. Y. 449.

² *Rensselaer, &c. R. R. Co. v. Davis*, 43 N. Y. 137; *Pacific R. R. Co. v. Seely*, 45 Mo. 212; *Occum Co. v. Sprague Manuf. Co.*, 34 Conn. 529, 541; *Bank of Michigan v. Niles, Walker (Mich.)*, 99.

It is clear that a corporation has no more right to purchase an equitable estate in land for an unauthorized

purpose, than to purchase a legal estate under similar circumstances. *Coleman v. San Rafael Turnpike Co.*, 49 Cal. 517.

³ *Infra*, § 362.

⁴ See 1 Bl. Com. 479; 2 Bl. Com. 268-273.

⁵ 2 Kent's Com. 282; *Lathrop v. Commercial Bank of Scioto*, 8 Dana (Ky.), 121; *Perin v. Carey*, 24 How. 465; *Page v. Heineberg*, 40 Vt. 81; *Downing v. Marshall*, 23 N. Y. 392; *Odell v. Odell*, 10 Allen, 1; *First Parish v. Cole*, 3 Pick. 239. The statutes of mortmain have been held to be in force in Pennsylvania, so far as they prohibit the dedication of lands to superstitious uses with-

have been enacted by many of the States, and are not infrequently contained in special charters of incorporation.

§ 329. **Construction of Provisions limiting the Right to acquire Property.**—There is no arbitrary rule of law for the construction of statutory provisions limiting the right of corporations to acquire and hold property. The application of such a provision to a particular case, and the effect of the legal prohibition upon an unauthorized acquisition of property, would depend upon the intention of the legislature; and this intention can ordinarily be ascertained only by considering the purpose for which the limitation was imposed.¹

If the right of a corporation to purchase lands is expressly limited to a certain amount in value, and the value of lands purchased by the company within its lawful powers is afterwards increased, by good husbandry or otherwise, so as to exceed the prescribed amount, the title of the corporation will not be affected thereby.² A prohibition from habitually dealing in a particular kind of property does not render a single purchase unauthorized.³

The nominal amount of the capital stock of a corporation, as fixed by its charter, does not *per se* limit the amount of property which it may acquire and hold. Thus, it has been held that a corporation whose capital was fixed at one million dollars might expend two millions in the site and erection of buildings, and, if necessary, contract debts for expenses incurred after its capital had been exhausted.⁴

§ 330. A corporation chartered to exist for a limited period of time only may nevertheless acquire title in fee to lands required for legitimate purposes.⁵ But it has been said

out statutory license. *Methodist Church v. Remington*, 1 Watts, 218. But they have been held not to be applicable to other corporations, whether foreign or domestic. *Runyan v. Coster*, 14 Pet. 122; *Leazure v. Hillegas*, 7 S. & R. 313, 320; *Miller v. Porter*, 53 Pa. St. 292.

¹ See *infra*, § 636 *et seq.*

² 2 Inst. 722; *Bogardus v. Trin-*

ity Church, 4 Sandf. Ch. 634; *Humbert v. Trinity Church*, 24 Wend. 587, 639; *Harvard College v. Aldermen of Boston*, 104 Mass. 470.

³ *Supra*, § 321.

⁴ *Barry v. Merchants' Exch. Co.*, 1 Sandf. Ch. 280; *State v. Morristown Fire Ass.*, 23 N. J. Law, 195.

⁵ *Nicoll v. New York, &c. R. R. Co.*, 12 N. Y. 121; *Rives v. Dud-*

that "a grant to a corporation aggregate, limited as to the duration of its existence, without words of perpetuity being annexed to the grant, would only create an estate for the life of the corporation."¹ This doctrine appears to be based upon a technicality of somewhat doubtful application. It is purely a question of intention whether a grant to a corporation whose duration is limited shall be a grant in fee or during the existence of the corporation. A grant to a corporation for a special purpose, which ends with the existence of the corporation, should be construed as a grant for the life of the corporation, and the same rule ought undoubtedly to be applied to a grant of new franchises or rights by the State.² But where property is purchased by and granted to a private joint-stock corporation in the course of its business, the grant should be construed as an absolute grant, unless the contrary be expressly provided. The fact that the charter of the company was of limited duration would certainly not, as a matter of law, prevent the company from receiving a grant in fee; nor would it raise a presumption that the parties intended the grant to be merely a lease for the term during which the charter was to be in force.

It has been doubted whether a corporation can execute a lease of property, or other engagement, extending over a period of time exceeding the duration of its charter;³ but these doubts appear to be unfounded. There is no reason why a different rule should be applied to corporations than to partnerships and unincorporated joint-stock companies. The period of time for which an association was formed may be an important element to be considered in determining whether or not a particular lease or engagement is authorized by the company's agreement of association or charter, but it

ley, 3 Jones, Eq. 126; *People v. Mauran*, 5 Denio, 389; *Asheville Div. No. 15 v. Aston*, 92 N. Car. 578.

¹ *Turnpike Co. v. Illinois*, 96 U. S. 63, 68. Land may be granted to a corporation in fee without the use of words of inheritance or the

words "successors." 2 Bl. Com. 109; *School District v. Everett*, 52 Mich. 314.

² *Turnpike Co. v. Illinois*, 96 U. S. 63, 68.

³ Compare *Northern Liberty Market Co. v. Kelly*, 113 U. S. 199.

would not determine absolutely whether the transaction was authorized or not.

§ 331. **Devises to Corporations.**—**The Statute of Wills.**—At common law, corporations as well as individuals could take personal property by bequest. But a devise of real estate was not allowed by the feudal law, and could not be made in England, except by way of use, until the Statutes of Wills were passed.¹ These statutes expressly excepted corporations from their operation, and a devise to a corporation directly remained impossible by operation of the common law.

It had been the custom, for some time before the Statutes of Wills had been passed, to avoid the rule of the feudal law against devises of lands, by application of the doctrine of uses; it being held that, while the land was not devisable, the use was not within the rule.²

The exception contained in the Statute of Wills with reference to devises to corporations does not specifically preclude a devise of a use or beneficial estate to a corporation, but refers merely to devises of lands, manors, &c. It therefore became a question whether, since the passage of the Statute of Wills, a corporation may take by devise such uses or trusts in lands as are not executed by the operation of the Statute of Uses. In *McCartee v. Orphan Asylum Society*,³ Chancellor Jones delivered an elaborate judgment, holding that a devise of a trust to a corporation was valid, notwithstanding the Statute of Wills; and this construction of the statute seems to be correct. It is to be observed, however, that a new Statute of Wills has been passed in New York since the decision last referred to. This statute provides that “no devise to a corporation shall be valid, unless such corporation be expressly authorized by its charter or by statute to take by devise”; and it has been held that devises of all kinds, whether directly or by way of use, are equally within the prohibition.⁴

¹ 32 Hen. VIII. c. 1; 34 Hen. VIII. c. 5. See 2 Bl. Com. 372.

² 2 Bl. Com. 375.

³ 9 Cow. 437. See *Downing v. Marshall*, 23 N. Y. 366, 384-386.

⁴ *Downing v. Marshall*, 23 N. Y.

Devises to corporations for charitable uses have been held valid by operation of the Statute of Charities where that statute is in force.¹

§ 332. **Construction of Statutes regulating Devises to Corporations.**—The right of corporations to take property by devise is regulated by statute in many of the States.

A distinction should be observed between those laws whose object is to regulate corporations in respect of their power of acquiring and holding property, and laws whose object is to restrict the power of testators to dispose of their property. Laws of the former description are enacted in pursuance of a general policy of preventing corporations from acquiring the ownership of real estate in the absence of express authority from the State. But laws prohibiting devises to corporations are intended to restrict the testamentary capacity of testators, and their object, in many instances, is to prevent testators from being driven by the improper use of religious influence to devise their property to religious institutions, and thus disinherit their heirs.

Accordingly, it has been held that, under a law declaring void all devises of lands to religious corporations, a devise of land to be converted into personalty and then to be paid over would be void also.² But if the charter or general laws governing a corporation prohibit the company from acquiring real estate by devise, this would not render void a devise of lands to be converted into personalty and then paid over; for the capacity of the corporation to take the property at the time it shall vest should be considered.³ It would seem equitable, that, if a devise of real estate to a corporation would be invalid on account of a simple absence of authority on the part of the corporation to receive it, the land should

366. See also *State v. Wiltbank*, 727; *Atty.-Gen. v. Skinner's Co.*, 2 Harr. (Del.) 18, and cases in next section. 2 Russ. 407; *McCartee v. Orphan Asylum Soc.*, 9 Cow. 437.

¹ 2 Bl. Com. 376; *Bene't College v. Bishop of London*, 2 Wm. Bl. 1182; *Atty.-Gen. v. Mayor*, 7 Taunt. 546; *Rolt's Case*, F. Moore, 888; *Atty.-Gen. v. Bowyer*, 3 Vesey,

² *State v. Wiltbank*, 2 Harr. (Del.) 18.

³ *American Bible Soc. v. Noble*, 11 Rich. Eq. 156; *Baker v. Clarke Institution*, 110 Mass. 88.

be converted into personalty, in order to carry out the intention of the testator.¹

§ 333. A law regulating the right of corporations to receive property by devise or otherwise forms part of the charter or constitution of every corporation formed under the law, and will therefore be recognized and given effect in foreign States.² But a law restricting the testamentary capacity of testators declares a local policy merely, and can have no force outside of the State by which it was passed.³ Accordingly, it has been held that a devise made in New York to a foreign corporation is void by operation of the Statute of Wills of New York, although the corporation had authority by its charter to receive the devise.⁴ But a New York corporation can take by devise in Connecticut, although the devise would be prohibited if made in New York; and the reason of this is, that the corporation carries with it its charter, but not the law of devises of New York.⁵

§ 334. **When a Corporation has implied Authority to hold Property in Trust.**—It seems to have been considered formerly that no corporation could hold property subject to a

¹ *Contra*, *Starkweather v. American Bible Soc.*, 72 Ill. 50.

² *Chamberlain v. Chamberlain*, 43 N. Y. 424; *Starkweather v. American Bible Soc.*, 72 Ill. 50. Compare *Hoyt v. Thompson*, 19 N. Y. 207; *Farmers' L. & T. Co. v. Harmony Fire, &c. Ins. Co.*, 51 Barb. 33.

³ See *infra*, § 944.

⁴ *White v. Howard*, 46 N. Y. 144, 165; *United States v. Fox*, 94 U. S. 315; s. c. 52 N. Y. 530; *Boyce v. City of St. Louis*, 29 Barb. 650.

It has been held in Maryland, that the provision of the bill of rights of that State declaring that every gift, sale, or devise of real or personal property for religious purposes to take effect after the death of the seller or donor, without the prior or subsequent assent of the legislature,

shall be void, is analogous to the British statutes of mortmain, and is designed to protect the people of Maryland from the same evils as those statutes; and the Supreme Court concluded that for this reason it has no application to gifts or devises of *personal property* to corporations chartered by other States. *Vansant v. Roberts*, 3 Md. 119; *Brown v. Thompkins*, 49 Md. 423. The correctness of this conclusion is certainly not beyond doubt.

⁵ *White v. Howard*, 38 Conn. 342; *Thompson v. Swoope*, 24 Pa. St. 474; *American Bible Soc. v. Marshall*, 15 Ohio St. 537. Compare *Kerr v. Dougherty*, 79 N. Y. 328. See *contra*, *semble*, *Starkweather v. American Bible Soc.*, 72 Ill. 54, and compare *Christian Union v. Yount*, 101 U. S. 352.

use or trust in favor of another; but this view is now wholly obsolete.¹ Indeed, charitable corporations must necessarily at all times have been able to hold property upon the charitable trusts which they were created to administer.

Whether a corporation may undertake the performance of a trust in a particular case depends both upon the provisions of the company's charter and upon the circumstances of the case. It is not necessary that the authority to assume a trust be conferred by express words, but it may be implied whenever the trust is in furtherance of the general objects of the corporation.² Thus, a banking corporation having authority to hold land as mortgagee may undoubtedly take the title as trustee with power of sale on non-payment of the debt. And it has been held, that, "wherever property is devised or granted to a corporation, partly for its own use and partly for the use of others, the power of the corporation to take and hold the property for its own use carries with it, as a necessary incident, the power to execute that part of the trust which relates to others."³

§ 335. **The Implied Right of transferring Property.**—A corporation has implied authority to dispose of any or all of its property, whenever this is deemed expedient in carrying out the purposes for which the company was chartered. Unless expressly restrained by law, a corporation may deal with its property in the same manner as an individual, in prosecuting its legitimate business.⁴ But this right of a corporation to

¹ In *Vidal v. Girard's Exrs.*, 2 How. 187, Justice Story said: "Although it was in early times held that a corporation could not take and hold real and personal estate in trust, upon the ground that there was a defect of one of the requisites to create a good trustee, namely, the want of confidence in the person, yet that doctrine has long since been exploded as unsound and too artificial; and it is now held that where a corporation has a legal capacity to take real and personal

estate, there it may take and hold it upon trust in the same manner and to the same extent as a private individual may do."

² Compare *Vidal v. Girard's Exrs.*, 2 How. 189; *Chapin v. School District*, 35 N. H. 445; *Phillips Academy v. King*, 12 Mass. 546; *Robertson v. Bullions*, 11 N. Y. 243.

³ *Per Walworth, Chancellor, In re Howe*, 1 Paige, 214.

⁴ *White Water, &c. Canal Co. v. Vallette*, 21 How. 424; *Barry v. Merchants' Exch. Co.*, 1 Sandf. Ch.

dispose of property held by it can be implied only provided it would not conflict with any express provision of the company's charter, or with the rights of other persons or of the public. Thus, a corporation having public duties to perform cannot alienate any property which is required in order to enable the company to perform these duties in a proper manner.¹ And a corporation cannot transfer property held by it in trust, if this would be a violation of the rights of the beneficiaries.

A conveyance of property by a corporation may be executed like a conveyance by an individual, through any agent having authority to represent the company for that purpose. It has been held that a statutory provision that it "shall be lawful for any corporation to convey lands by deed of bargain and sale, sealed with the common seal of said corporation, and signed by the president or presiding member or trustee and two other members of the corporation, and attested by a witness," did not prohibit other methods of execution by authorized agents.²

§ 336. **The Implied Right of entering into Contracts.**—A corporation has implied authority to act in the same manner as a copartnership, in carrying on its legitimate business; and therefore it may enter into any contract which is reasonably adapted to further the enterprise for which it was chartered, unless it be restrained by the charter or by a general law.³

§ 337. **How a Corporation may enter into Contracts.**—Corporations almost universally enter into contracts through

280; *Dupee v. Boston Water Power Co.*, 114 Mass. 37; *Burton's Appeal*, 57 Pa. St. 213; *Miners' Ditch Co. v. Zellerbach*, 37 Cal. 543; *Reynolds v. Commissioners*, 5 Ohio, 204; *Town Council v. Elliott*, 5 Ohio St. 113; *Buell v. Buckingham*, 16 Iowa, 284; *Binney's Case*, 2 Bland's Ch. 142; *Aurora Agr. &c. Soc. v. Pad-dock*, 80 Ill. 263; *Re Patent File Co.*, L. R. 6 Ch. 83; and see cases in Part II. of this chapter.

As to the right of a corporation

to make an assignment for the benefit of creditors, see *infra*, § 782.

¹ *Infra*, § 1020.

² *Bason v. Mining Co.*, 90 N. Car. 417; *Morris v. Keil*, 20 Minn. 531.

³ *White Water, &c. Canal Co. v. Vallette*, 21 How. 424; *Barry v. Merchants' Exch. Co.*, 1 Sandf. Ch. 289; *Thompson v. Lambert*, 44 Iowa, 239; *Old Colony R. R. Co. v. Evans*, 6 Gray, 38, 39; *Scottish, &c. Ry. Co. v. Stewart*, 3 Macq. 415.

their duly accredited agents; indeed, it would be practically impossible, in most cases, for the whole body of corporators to act directly.

It has always been held that a corporation may give its assent to a contract by vote of its shareholders or members, at a meeting duly convened.¹ In such case the majority speak as agent for the whole association; and the powers of the majority are derived directly from the unanimous agreement of the corporators.² As a rule, however, corporations contract through a board of directors or inferior agents, whose powers are fixed by the provisions of the charter, by the terms of their appointment, or by custom.³

§ 338. *The Use of a Seal is unnecessary.*—In former times it was held that a corporation could not express its will, or enter into a contract, except through an instrument under seal, executed by a duly constituted agent. This doctrine certainly had no principle based upon reason to support it; on the contrary, it seems to have been a result of the ignorance of the art of writing during the dark ages. It was never rigorously applied in all cases,—which shows that it did not result from the nature of a corporation; and in modern times the ancient rule has been wholly discarded.⁴ It is now a rule well settled throughout the United States, that a corporation may make a contract without the use of a seal, in all cases in which this may be done by an individual;⁵

¹ *Maxwell v. Dulwich College*, 1 Fonbl. Eq. 306, note *o*; *Bank of U. S. v. Dandridge*, 12 Wheat. 68; *Fleckner v. Bank of U. S.*, 8 Wheat. 338; *Union Bank v. Ridgley*, 1 H. & G. 425.

² *Infra*, § 454. It has often been decided that a corporation may ratify an unauthorized act, performed on its behalf, by mere acquiescence, or by the unanimous agreement of its shareholders. See *infra*, § 603. *Crook v. Corporation of Seaford*, L. R. 6 Ch. 551.

³ *Infra*, § 483 *et seq.*

⁴ See Angell & Ames on Cor-

porations, §§ 215–219, 228, where the history of seals is very fully discussed. See also *Baptist Church v. Mulford*, 3 Halst. L. 183.

⁵ *Bank of Columbia v. Patterson*, 7 Cranch, 299; *Fleckner v. Bank of U. S.*, 8 Wheat. 338; *Bank of U. S. v. Dandridge*, 12 Wheat. 64; *Whitford v. Laidler*, 94 N. Y. 145; *Baptist Church v. Mulford*, 3 Halst. L. 185, and cases cited; *McCullough v. Talladega Ins. Co.*, 46 Ala. 376; *Trustees of University v. Moody*, 62 Ala. 389; *Christian Church v. Johnson*, 53 Ind. 273; *Sheffield School Township v. An-*

and it is equally well settled that an agent of a corporation may be appointed without the use of a seal, whatever may be the purpose of the agency.¹

The English courts have held more firmly to the time-honored doctrine;² but even in England it is settled law that a private corporation established for purposes of trade or traffic has implied authority to make any contract in the direct course of the business which it was chartered to carry on, in the same manner as an individual, without the use of the corporate seal.³

dress, 56 Ind. 157; *Merrick v. Burlington, &c. Plank Road Co.*, 11 Iowa, 75; *Town of New Athens v. Thomas*, 82 Ill. 259; *Buckley v. Briggs*, 30 Mo. 452. Numerous cases in which this rule was assumed to be the law may be found in the reports of every State of the Union.

A certificate for shares in a corporation requires no seal. *Halstead v. Dodge*, 51 N. Y. Super. Ct. 169.

¹ *Fleckner v. Bank of U. S.*, 8 Wheat. 357; *Osborn v. Bank of U. S.*, 9 Wheat. 738; *Bank of U. S. v. Dandridge*, 12 Wheat. 70; *Western Bank v. Gilstrap*, 45 Mo. 419; *Randall v. Van Vechten*, 19 Johns. 60; *Perkins v. Washington Ins. Co.*, 4 Cow. 645; *Mumford v. Hawkins*, 5 Denio, 355; *Buncombe Turnpike Co. v. McCarson*, 1 Dev. & B. 306; *Lathrop v. Commercial Bank*, 8 Dana, 114; *Garrison v. Combs*, 7 J. J. Marsh. 85; *Everett v. United States*, 6 Port. 166; *Bates v. Bank of Alabama*, 2 Ala. 461; *St. Andrew's Bay Land Co. v. Mitchell*, 4 Fla. 192; *Savings Bank v. Davis*, 8 Conn. 191; *Stamford Bank v. Benedict*, 15 Conn. 445; *Despatch Line v. Bellamy Manuf. Co.*, 12 N. H. 205; *Goodwin v. Union Screw Co.*, 34 N. H. 378; *Badger v. Bank of Cumberland*, 26 Me. 428; *Trundy*

v. Farrar, 32 Me. 225; *Thayer v. Middlesex, &c. Ins. Co.*, 10 Pick. 326; *Sherman v. Fitch*, 98 Mass. 59; *Narragansett Bank v. Atlantic Silk Co.*, 3 Metc. (Mass.) 282; *Wolf v. Goddard*, 9 Watts, 544; *Northern Central Ry. Co. v. Bastian*, 15 Md. 494; *Covington v. Covington, &c. Bridge Co.*, 10 Bush, 69; *Smiley v. Mayor, &c. of Chattanooga*, 6 Heisk. 604; *Santa Clara Mining Ass. v. Meredith*, 49 Md. 389; *Crowley v. Genesee Mining Co.*, 55 Cal. 273.

² *Mayor of Ludlow v. Charlton*, 6 M. & W. 815; *Mayor of Kidderminster v. Hardwick*, L. R. 9 Exch. 24; *Arnold v. Mayor of Poole*, 4 M. & G. 860; *Diggle v. London, &c. Ry. Co.*, 5 Exch. 442; *Paine v. Strand Union*, 8 Q. B. 326; *Homersham v. Wolverhampton W. W. Co.*, 6 Exch. 137; *Dyte v. St. Pancras Board of Guardians*, 27 L. T. n. s. 342; *Austin v. Guardians of Bethnal Green*, L. R. 9 C. P. 91.

³ *Henderson v. Australian, &c. Nav. Co.*, 5 El. & Bl. 409; *Australian, &c. Nav. Co. v. Marzetti*, 11 Exch. 228; *Reuter v. Electric Telegraph Co.*, 6 El. & Bl. 341; *South of Ireland Colliery Co. v. Waddle*, L. R. 3 C. P. 463; L. R. 4 C. P. 617; *Brown v. Town of Belleville*, 30 U. C. Q. B. 373. Compare, however, *Diggle v. London, &c. Ry.*

If the charter of a corporation provides expressly that contracts entered into by the company shall be sealed with the corporate seal, it is clear that authority to enter into contracts without the use of a seal cannot be presumed, under ordinary circumstances;¹ and the legal validity of a contract entered into under these circumstances, without the application of a seal, will be governed by the rules which determine the liability of corporations for acts performed by their agents in disregard of formalities prescribed by law.

It is still held that the answer of a corporation to a bill in chancery must be under seal.² But an attorney does not need a power under seal in order to consent to a reference on behalf of the corporation.³

§ 339. **The Validity of Sealing.** — The seal of a corporation must necessarily be affixed by an agent acting on behalf of the company; and, if used by an agent without authority, the sealing will not bind the company. "The mere fact that a deed has the corporate seal attached does not make it the act of the corporation, unless the seal was placed to it by some one duly authorized."⁴ But the common law rule, that an agent must have a power of attorney under seal in order to bind his principal by a contract under seal, cannot in the nature of things be applied to the agents of a corporation; for they must ultimately derive their authority from the vote of the corporators or board of directors.⁵ In those cases in which a vote is sufficient authority to an agent to do

Co., 5 Exch. 442; *London Dock Co. v. Sinnott*, 8 El. & Bl. 347.

¹ *Freud v. Dennett*, 27 L. J. (C. P.) 314; *Crampton v. Varna Ry. Co.*, L. R. 7 Ch. 562.

² 1 *Daniell's Ch. Pr.* 146; *Bronson v. La Crosse R. R. Co.*, 2 Wall. 302; *French v. First Nat. Bank*, 11 N. B. R. 189; *Ransom v. Stonington Sav. Bank*, 2 Beasl. 212.

³ *Paret v. City of Bayonne*, 39 N. J. Law, 559. Compare *Cape Sable Co.'s Case*, 3 Bland, 606.

⁴ *Koehler v. Black River, &c.*

Iron Co., 2 Black, 716; *Damon v. Granby*, 2 Pick. 353; *Jackson v. Campbell*, 5 Wend. 572; *Hoyt v. Thompson*, 5 N. Y. 320; *D'Arcy v. Tamar, &c. Ry. Co.*, L. R. 2 Exch. 158.

⁵ *Howe v. Keeler*, 27 Conn. 538; *Beckwith v. Windsor Manuf. Co.*, 14 Conn. 594; *Savings Bank of N. H. v. Davis*, 8 Conn. 191; *Hopkins v. Gallatin Turnpike Co.*, 4 Humph. 403; *Burr v. McDonald*, 3 Gratt. 215; *Hutchins v. Byrnes*, 9 Gray, 367.

an act, it will be sufficient as a ratification of the act when performed without authority.¹

A corporation, like an individual, may adopt any seal which is convenient for the occasion;² but the seal must be affixed as the seal of the corporation.³ The seal of a corporation must be proven whenever that of an individual must be proven; it is only in case of public corporations, such as the State, that all parties must at their peril take notice of the official seal.⁴

§ 340. **The Necessity of Proving the Authority to execute a Contract under Seal.**—It has sometimes been said, that, if the seal of a corporation appears to be affixed to an instrument, the presumption is that it was rightfully affixed,—that the seal is itself *prima facie* evidence that it was affixed by the proper authority.⁵ The meaning of these statements is not perfectly clear. The seal of a corporation certainly has no mysterious virtue not possessed by other seals; and a contract under seal executed by the agents

¹ *Howe v. Keeler*, 27 Conn. 538, 554; *Eureka Co. v. Bailey Co.*, 11 Wall. 488; *Despatch Line v. Bellamy Manuf. Co.*, 12 N. H. 205; *Fleckner v. Bank of U. S.*, 8 Wheat. 338; *Chicago, &c. Ry. Co. v. James*, 24 Wis. 388.

² *Shep. Touchst.* 57; *Ransom v. Stonington Sav. Bank*, 2 Beasl. 212; *Tenney v. East Warren Lumber Co.*, 43 N. H. 343; *Bank of Middlebury v. Rutland, &c. R. R. Co.*, 30 Vt. 159; *Porter v. Androscoggin, &c. R. R. Co.*, 37 Me. 349; *Reynolds v. Glasgow Academy*, 6 Dana, 37; *Mill Dam Foundry v. Hovey*, 21 Pick. 417; *Stebbins v. Merritt*, 10 Cush. 27; *Johnston v. Crawley*, 25 Ga. 316; *Eureka Co. v. Bailey Co.*, 11 Wall. 491; *Taylor v. Heggie*, 83 N. Car. 244; *Kansas City v. Hannibal, &c. R. R. Co.*, 77 Mo. 180.

³ *Bank of Metropolis v. Gutschlick*, 14 Pet. 29; *Randall v. Van*

Vechten, 19 Johns. 60; *Brinley v. Mann*, 2 Cush. 337. Compare *Sherman v. Fitch*, 98 Mass. 59; *Haven v. Adams*, 4 Allen, 80; *Hutchins v. Byrnes*, 9 Gray, 367; *Taylor v. Heggie*, 83 N. Car. 244.

⁴ *Foster v. Shaw*, 7 S. & R. 156; *Leazure v. Hillegas*, Id. 313; *Farmers', &c. Turnpike Co. v. McCullough*, 25 Pa. St. 304; *Crossman v. Hilltown Turnpike Co.*, 3 Grant's Cas. 225; *Jackson v. Pratt*, 10 Johns. 381; *Mann v. Pentz*, 2 Sandf. Ch. 257; *Den v. Vreelandt*, 7 N. J. Law, 352; *Doe v. Chambers*, 4 Ad. & El. 412; *City Council v. Moorhead*, 2 Rich. Law, 430.

⁵ *Mickey v. Stratton*, 5 Sawy. 475; *Southern Cal. Colony Ass. v. Bustamente*, 52 Cal. 192; *Wood v. Whelen*, 93 Ill. 153, 162; *Indianapolis, &c. R. R. Co. v. Morgans*, 103 Ill. 149; and see cases *infra*, §§ 596, 597.

of a corporation is subject to the same rules of evidence, and of law, as a similar contract executed by the agents of an individual.

In order to prove the execution of a contract purporting to have been executed under the corporate seal, two facts must be shown. First, it must be shown that the agents by whom the contract purports to have been executed were in fact agents of the corporation, having authority to execute the contract in question, or contracts of that general description; and, secondly, it must be shown that the signatures are genuine, or, in other words, that these agents did actually execute that particular contract. The mere circumstance that a seal was affixed to the contract would evidently not tend to establish either one of these facts.

The principles of the law of agency apply to contracts under seal, as well as to other contracts. The general rule is, that the authority of the agent executing a contract under seal must be shown before the principal can be held.¹ But if it appears that the agent executing the contract had authority to execute a contract of that description under ordinary circumstances, it will be presumed that the agent acted pursuant to his authority unless some evidence to the contrary is adduced.²

These presumptions are founded on reason; but there is no rule of law which gives the seal of a corporation any peculiar efficacy or virtue. At the present day the affixing of the corporate seal to the contracts of a corporation is in most instances superfluous. But where a seal is necessary it must be proven, as in any other case of a contract signed and sealed by an agent.

§ 341. **The Legal Effect of Sealing.—The Necessity of a Consideration.**—It is still the custom to affix the corporate seal to many classes of contracts which were formerly required to be under seal, but which may to-day be executed without the use of a seal. It seems that a contract having the corporate seal affixed must always be declared upon, at common

¹ *Infra*, § 596.

² *Infra*, § 577. See *Bason v. Mining Co.*, 90 N. Car. 417.

law, as a bond or contract under seal.¹ But it is well settled that promissory notes issued by corporations do not lose their qualities as negotiable instruments merely because they were sealed with the corporate seal. Bonds issued by corporations in negotiable form have been treated as negotiable, by universal custom, for a long period of time, and this custom has been fully sanctioned by judicial recognition.²

Statements may be found in the books, to the effect that the common law rule, that a contract under seal must be presumed to have a consideration, applies to contracts under seal executed on behalf of corporations, as well as to similar contracts executed by individuals.³ These statements seem to imply a misapprehension of the common law rule, and are not strictly correct. By the common law a contract under seal does not require a consideration to be binding; it is immate-

¹ *Porter v. Androscoggin, &c. R. R. Co.*, 37 Me. 349; *Benoist v. Carondelet*, 8 Mo. 250; *Clark v. Farmers', &c. Manuf. Co.*, 15 Wend. 256.

These cases do not state the law of to-day so far as they hold that promissory notes are not negotiable because under the corporate seal.

² *White v. Vermont, &c. R. R. Co.*, 21 How. 575; *Moran v. Miami County*, 2 Black, 722; *Mercer County v. Hackett*, 1 Wall. 95; *Murray v. Lardner*, 2 Wall. 110; *Clark v. Iowa City*, 20 Wall. 583; *Brainerd v. New York, &c. R. R. Co.*, 25 N. Y. 496; *Haven v. Grand Junction R. R., &c. Co.*, 109 Mass. 88; *Miller v. Rutland, &c. R. R. Co.*, 40 Vt. 399; *National Exch. Bank v. Hartford, &c. R. R. Co.*, 8 R. I. 375; *Morris Canal, &c. Co. v. Fisher*, 9 N. J. Eq. 699; *Beaver County v. Armstrong*, 44 Pa. St. 63; *Bunting's Admr. v. Camden, &c. R. R. Co.*, 81 Pa. St. 254; *Mason v. Frick*, 105 Pa. St. 162; *Philadelphia, &c. R. R. Co. v. Smith*, 105 Pa. St. 195; *Same v. Fidelity Co.*, Id. 216; *Morris Canal, &c. Co. v. Lewis*, 12 N. J.

Eq. 323; *Winfield v. Hudson*, 28 N. J. Law, 255; *Barrett v. Schuyler County Court*, 44 Mo. 197; *Smith v. Clark County*, 54 Mo. 58; *Re General Estates Co.*, L. R. 3 Ch. 758; *Re Land Credit Co. of Ireland*, L. R. 4 Ch. 460; and see *Jones on Railroad Securities*, §§ 197-210.

In *White v. Vermont, &c. R. R. Co.*, *supra*, Justice Nelson said, with regard to railroad bonds: "As to the negotiability of this class of securities, when shown to be intended that they should possess this character by the form in which issued, and mode of giving them circulation, we think the usage and practice of the companies themselves, and of the capitalists and business men of the country dealing in them, as well as the repeated decisions or recognition of the principle by courts and judges of the highest respectability, have settled the question." See also cases cited.

³ *Royal Bank of Liverpool v. Grand Junction R. R., &c. Co.*, 100 Mass. 445; *Sturtevant v. Alton*, 3 McLean, 395.

rial whether there be a consideration or not. This rule was not originally established by raising a supposed presumption; nor does the presence of a seal in fact give rise to the slightest presumption that the contract really had a consideration. The idea that a seal imports a consideration appears to have resulted from a mistaken notion that every contract must have or ought to have a technical consideration.

The contracts of a corporation must be executed by its agents, and no agent of a corporation has authority to give away the corporate funds, or to enter into contracts on behalf of the corporation, except in managing its business under the authority conferred by the charter. Contracts without a valuable consideration or *quid pro quo* would, under ordinary circumstances, be unauthorized, and in excess of the powers conferred upon the company's agents. If then the affixing of a seal to a contract raises no actual presumption of a consideration, it cannot tend to prove that the agent executing the contract acted within the scope of his authority. It would seem to follow, that a plaintiff cannot recover upon a bond or contract under seal purporting to have been executed on behalf of a corporation, by merely proving its execution, and without showing that it was executed for a valuable consideration, and under circumstances under which the agent had power to bind the company.¹

§ 342. **The Implied Right of Borrowing and incurring Debts.** — Corporations have implied authority to borrow money and incur debts for the purpose of accomplishing their legitimate purposes, unless the contrary be expressly provided; and authority to borrow includes authority to give a written acknowledgment of indebtedness in the usual form.²

¹ See *per* Lord Campbell, C. J., 274, 282; *Comrs. of Craven v. Atlantic, &c. R. R. Co.*, 77 N. Car. 289; *Ry. Co.*, 4 El. & Bl. 443, 444.

² *Memphis, &c. R. R. Co. v. Dow*, 267; *Barry v. Merchants' Exch. Co.*, 1 Sandf. Ch. 280; *Beers v. Phoenix Glass Co.*, 14 Barb. 358; *Partridge v. Badger*, 25 Barb. 146; *Clark v. Titcomb*, 42 Barb. 122; *Curtis v. Leavitt*, 15 N. Y. 9; *Barnes v. On-*

The borrowing of money is merely a *means* of arriving at the ultimate purposes of a corporation; and hence authority to borrow can be implied only where the loan is made for a purpose which was authorized by the company's charter. Some kinds of corporations, like banks, must borrow money daily, in carrying on their ordinary affairs;¹ in other cases, the business of a corporation may not require it to borrow except under extraordinary circumstances. But it may be stated as a general rule, that every corporation has implied authority to borrow money whenever the borrowing of money is a reasonable method of carrying out the purposes for which the company was chartered.²

tario Bank, 19 N. Y. 152; Smith v. Law, 21 N. Y. 296; Nelson v. Eaton, 26 N. Y. 410; Bradley v. Ballard, 55 Ill. 413; Lucas v. Pitney, 3 Dutch. 221; Mobile, &c. R. R. Co. v. Talman, 15 Ala. 472; Moss v. Harpeth Academy, 7 Heisk. 285; Oxford Iron Co. v. Spradley, 46 Ala. 98; Alabama, &c. Ins. Co. v. Central Agr., &c. Ass., 54 Ala. 73; Bank of Chillicothe v. Chillicothe, 7 Ohio (Part 2), 31; Ridgway v. Farmers' Bank, 12 S. & R. 256; Magee v. Mokelumne Hill Canal, &c. Co., 5 Cal. 258; Union Mining Co. v. Rocky Mt. Nat. Bank, 2 Col. 248; Hamilton v. Newcastle, &c. R. R. Co., 9 Ind. 359; Rockwell v. Elkhorn Bank, 13 Wis. 653; Fay v. Noble, 12 Cush. 1; Commercial Bank v. Newport Manuf. Co., 1 B. Monr. 14.

A corporation may raise money by selling accommodation notes issued to it for that purpose. Holbrook v. Basset, 5 Bosw. 147; Furniss v. Gilchrist, 1 Sandf. (Super. Ct.) 53.

¹ Bank of Australasia v. Breillat, 6 Moore, P. C. 152, 193-195; Forbes v. Marshall, 24 L. J. Exch. 305.

² In Gibbs & West's Case, L. R. 10 Eq. 311, Vice-Chancellor

Malins said: "It has been very strongly urged in this case, that, the company having no power to borrow, the borrowing was *ultra vires* and improper, and that therefore no debt was created. I should say — as, indeed, I have already said on many occasions — that in the ordinary course of transactions of a mercantile concern, whether it be an insurance office or anything else, where the possession of money is essential for the purpose of carrying on the business, if the company finds itself in temporary difficulties for want of money, I cannot consider it beyond the powers of the directors to obtain money from their bankers, or others who will temporarily lend it to them, for the purpose of preventing that which would be disastrous to all, — namely, the stoppage of the company; that is to say, I cannot consider it beyond their powers to prevent that disaster by means of loans to a moderate extent, such as would not be unreasonable, having regard to the nature and extent of the business in which the company is engaged, for the purpose of carrying on the business of the company." See also Australian, &c. Co. v. Mounsey, 4 K. & J. 733.

In some cases, however, the borrowing of money would not be required, under any circumstances, in carrying on the legitimate business of a company ; as, for example, where other means are provided for obtaining funds.¹

§ 343. The right of a corporation to borrow money is necessarily subject to all express limitations contained in the company's charter. If the right of borrowing is limited by the charter to a definite sum, it is clear that the company and its agents will not be authorized to borrow after the prescribed limit has been reached.² But it does not follow that an unauthorized loan would necessarily be void. The validity of an unauthorized loan would depend upon the established rules of the law of agency, and the effect of the common law rule prohibiting unauthorized corporate acts.³

§ 344. **When a Limitation of the Right of Borrowing does not restrict the Right of incurring Debts.** — A limitation upon the right of a corporation to borrow money does not necessarily restrict the right of the company to incur debts in the course of its usual business. A provision limiting the right of borrowing is intended to protect the shareholders against loss through any improper expansion of the company's business beyond the limits contemplated by the charter. After the capital of the company has been invested, and the borrowing power has been exhausted, no new funds can be raised for the development of the company's business, but it does not follow that the company's business must be stopped and wound up at that moment. The company would still be authorized to continue its ordinary business, and take care of its property, in the same manner as a prudent individual under similar circumstances, and the right to incur debts for necessary purposes would follow as a consequence.

Thus, it has been held that the right of a mining company to incur debts for labor and supplies needed in the usual

¹ See *Ex parte Williamson*, L. R. 5 Ch. 312; *Re German Mining Co.*, 4 De G., M. & G. 19; *Laing v. Reed*, L. R. 5 Ch. 4; *State v. Oberlin Building Ass.*, 35 Ohio St. 258.

² *Fountaine v. Carmarthen Ry. Co.*, L. R. 5 Eq. 316.

³ *Infra*, §§ 580, 581.

course of its operations¹ would not be limited by a restriction upon the power of borrowing.

*Re German Mining Company*² is a leading authority upon this point. A registered joint-stock company was formed in England for working mines in Germany, subject to the terms of a deed of settlement, which provided that the capital should be £50,000, and gave no powers to the directors to raise money except by the creation of new shares; and the power of borrowing may be held not to have existed. The capital was paid up and proved insufficient for working the mines. The wages of the miners being in arrear, and other debts being due, the managing directors obtained advances from some of the shareholders for the purpose of paying those debts and preventing the mines from being seized under the law of the country where they were situated. The directors also borrowed other sums, on their personal guaranty, from the bankers of the company, not for payment of debts, but for carrying on the business of the company in its ordinary course, and afterwards repaid the bankers these advances. Upon application of the directors and shareholders who had thus advanced funds for the use of the company to be repaid the amount of these advances, the Lords Justices held that the borrowing of money was not authorized by the company's deed, and that the advances obtained by the directors did not constitute a debt due from the company; but they also held that, inasmuch as the money had been applied in paying off debts which the directors had authority to contract, the lenders were entitled to recover.³

¹ *Tredwen v. Bourne*, 6 M. & W. 464; *Hawken v. Bourne*, 8 M. & W. 703. Compare *Hawtayne v. Bourne*, 7 M. & W. 595; and see *Re German Mining Co.*, 4 De G., M. & G. 40, *per* Turner, L. J. *Co.*, 22 Beav. 143; and see cases *supra*, § 123. These cases have been very severely criticised in 1 Lindley on Partnership (4th ed.), 761.

² 4 De G. M. & G. 19. See also *Lowndes v. Garnett, &c. Mining Co.*, 33 L. J. Ch. 418; *Re Cork & Youghal Ry. Co.*, L. R. 4 Ch. 748; *Ulster Ry. Co. v. Banbridge, &c. Ry. Co.*, Ir. R. 2 Eq. 190; *Re Norwich Yarn* ³ Lord Justice Turner said, in delivering judgment: "It was said that this was a concern with a limited capital, and that the directors could not be justified in expenditure beyond the capital; but this deed must be construed like other part-

§ 345. The case of the German Mining Company should be compared with that of the Worcester Corn Exchange

nership deeds. In all such cases the capital is limited, but the engagement of the partnership cannot be measured by the extent of the capital. New undertakings were not indeed to be entered into after the full capital had been embarked, nor is it suggested that any such were entered into, but how was the expenditure upon the existing undertakings to be measured by the extent of the capital? Was the concern to be stopped at the moment when the expenditure equalled the capital, and how, in a concern of this nature, was it to be ascertained when that moment had arrived? . . . Upon the evidence of this case, I think it must be taken that the mines have been continued, not for the purpose of continuing and carrying on the business of the company, but with a view to a more advantageous sale of the mines being ultimately effected; and if the directors, in the *bona fide* exercise of their discretion, and their *bona fides* is not questioned, thought proper to continue the mines for this purpose, I see no ground on which the appellants can found any objection upon the ground of the mines having been so continued. The case must, in my opinion, depend upon the broad and general positions on which the appellants relied. . . . The appellants' argument on this point rested mainly upon several cases which have been determined at law, *Burmester v. Norris* (6 Exch. 796), *Ricketts v. Bennett* (4 C. B. 686), and the cases there cited. Those cases seem to me fully to establish this position that the acting manager of a mine, whether he be a shareholder in the mine or not,

has no power to render his co-shareholders liable for money borrowed, although it may be borrowed for the necessary purpose of carrying on, or even of preserving, the mine; and the appellants, adopting this position, contended that the distinction between moneys borrowed and debts contracted was too narrow and refined to be acted upon by the courts. But this distinction seems to be established, and to rest upon sound principles." (The Lord Justice here referred to *Hawtayne v. Bourne*, 7 M. & W. 595, and *Hawken v. Bourne*, 8 M. & W. 703.) "It is not according to the usual course of business for the manager of a mine to borrow moneys for the purpose of carrying on the mine, and therefore, where money is lent to the manager of a mine, the party lending it must look to the power of borrowing with which the manager is invested, and can recover over against the parties who have authorized the borrowing of the money; but, on the other hand, wages must become due to the miners, and goods must be bought upon credit by the manager of a mine, and the shareholders therefore are considered to have authorized the manager to incur such expenses and contract such debts, and consequently are held liable for such expenses and debts. Surely this distinction is sound in principle." 4 De G., M. & G. 39-43. See also *Lowndes v. Garnett, &c. Mining Co.*, 33 L. J. Ch. 418, *per* Page-Wood, V. C.

The cases above referred to must not be understood as deciding that the directors of an ordinary mining company cannot borrow money where there is no express provision

Company.¹ A company had been formed for the purpose of erecting a corn exchange, and the management of the company was placed in the hands of a board of directors. The building was to be paid for out of calls levied upon the shareholders; but the liability of each shareholder was expressly limited to a certain sum. The building cost more than was expected, and the directors borrowed the excess. Lord Cranworth, L. C., held that the shareholders were not liable, because the directors had no power to charge them beyond the amount fixed by the deed.

The difference between this case and *Re German Mining Co.* was pointed out by Lord Justice Turner in his judgment in the latter case. He said: "That case appears to me to be wholly different from the present. In that case a particular sum was subscribed for the purpose of being expended upon a particular building. There was no trade to be carried on requiring continued expenditure."²

§ 346. **The Right of Mortgaging.**— Authority to borrow money or incur an indebtedness generally includes authority to give a mortgage upon the corporate property as security.

The power of mortgaging, like any other power, can be exercised by a corporation only in carrying on its legitimate business. If a corporation holds its property upon a trust in favor of another, it is plain that the company can have no authority to mortgage the property in violation of the trust. And so, where the use of property obtained by a corporation through the assistance of the State is necessary in order to enable the company to perform obligations assumed by it for the benefit of the public, no authority to mortgage such property can be implied; for, if the power of mortgaging were conceded under these circumstances, the corporation might indirectly deprive itself of the means of performing its duties to the public.³

In the absence of a restriction of this character, or an

to the contrary. See *Union Mining Co. v. Rocky Mt. Nat. Bank*, 2 Col. 248; *Bradley v. Ballard*, 55 Ill. 413; *Moss v. Averell*, 10 N. Y. 457.

¹ *Re Worcester Corn Exchange Co.*, 3 De G., M. & G. 180.

² 4 De G., M. & G. 43.

³ *Infra*, § 1020.

express prohibition by charter, it would seem to be settled law that the right of mortgaging may always be implied where there is authority to borrow or to incur an indebtedness, and to alien the subject matter of the mortgage. The right of mortgaging follows as a necessary incident to the right of managing the business of a corporation according to the usual methods of business men.¹

§ 347. If the charter of a corporation expressly confers authority to execute one kind of security, as by mortgage upon the corporate property and franchises, this does not impliedly preclude the right of giving other security, as, for example, by pledge.² Nor does an express grant of authority to mortgage for a particular purpose take away the implied authority to mortgage for any other legitimate purpose.³

A simple prohibition from mortgaging does not affect the right of borrowing; and a loan on mortgage or other security which was unauthorized may stand as a simple debt.⁴ So a mortgage to secure an unauthorized issue of bills may

¹ *Barry v. Merchants' Exch. Co.*, 1 Sandf. Ch. 280; *King v. Same*, 5 N. Y. 547; *Curtis v. Leavitt*, 15 N. Y. 9; *Nelson v. Eaton*, 26 N. Y. 410; *Clark v. Titcomb*, 42 Barb. 122; *Jackson v. Brown*, 5 Wend. 590; *State v. Rice*, 65 Ala. 83; *Jones v. Guaranty, &c. Co.*, 101 U. S. 622; *Detroit v. Mutual Gas Light Co.* 43 Mich. 594; *Memphis, &c. R. R. Co. v. Dow*, 19 Fed. R. 388; *Hopson v. Ætna Axle, &c. Co.*, 50 Conn. 597; *Gordon v. Preston*, 1 Watts, 385; *Watts's Appeal*, 78 Pa. St. 370; *Aurora Agricultural, &c. Soc. v. Paddock*, 80 Ill. 263; *West v. Madison County Agricult. Board*, 82 Ill. 205; *Burt v. Rattle*, 31 Ohio St. 116; *Burr v. McDonald*, 3 Gratt. 215; *Susquehanna Bridge, &c. Co. v. General Ins. Co.*, 3 Md. 305; *Thompson v. Lambert*, 44 Iowa, 244; *Bardstown, &c. R. R. Co. v. Metcalfe*, 4 Metc. (Ky.) 199; *Pierce v. Emery*, 32 N. H. 503; *Richards v. Merrimack, &c. R. R. Co.*, 44 N. H. 127; *Methodist Episc. Ch. of Kendallville v. Shulze*, 61 Ind. 511; *Australian, &c. Steam Clipper Co. v. Mounsey*, 4 K. & J. 733; *Re Patent File Co.*, L. R. 6 Ch. 83; *Shears v. Jacob*, L. R. 1 C. P. 513. Compare *Commonwealth v. Smith*, 10 Allen, 448.

² *Uncas National Bank v. Rith*, 23 Wis. 339. See also *Talladega Ins. Co. v. Peacock*, 67 Ala. 253. Compare *National Bank v. Insurance Co.*, 41 Ohio St. 1.

³ *Allen v. Montgomery R. R. Co.*, 11 Ala. 438.

⁴ *Payne v. Mayor of Brecon*, 3 H. & N. 572; *Holdsworth v. Mayor of Dartmouth*, 11 A. & E. 490; *Utica Insurance Co. v. Scott*, 19 Johns. 1.

be a valid security for the debt, though the bills be legally void.¹

§ 348. **Mortgages by Manufacturing Corporations under the Laws of New York.**—Corporations organized in New York under the general law of 1848, for the formation of manufacturing corporations, were prohibited by the second section of that act from executing mortgages or creating liens upon their property. Subsequently, by the act of 1864, it was provided that such companies might “secure the payment of any debt . . . by mortgaging all or any part of their real estate, . . . provided the written assent of at least two thirds of the capital stock be first filed in the office of the clerk of the county where the mortgaged property is situated.”²

The Court of Appeals of New York held, under this law, that a mortgage, executed by a corporation in the form of a deed of trust to secure the payment of its negotiable bonds, to be issued thereafter, was authorized; that it was not essential that the debts to be secured by the mortgage should be in existence at the time of the execution of the mortgage and bonds, but that the statute was complied with if the bonds were negotiated only for the purpose of securing or paying debts contracted before the bonds were actually issued, the security of the creditors then first coming into existence.³

In *Carpenter v. Black Hawk Gold Mining Co.*,⁴ the court took the view that a mortgage was authorized by the law only to secure the payment of existing debts, and that it could not be executed to secure debts contracted simultaneously, or as a means of raising money to carry on the company's business; but this view has since been disapproved by the court, and would probably not be followed.⁵

§ 349. **The Power of Pledging.**—A corporation has implied authority to pledge any personal property which it may law-

¹ *Scott v. Colburn*, 26 Beav. 276. N. Y. 43; *Vail v. Hamilton*, 85

² Laws of 1848, chap. 4, § 2; N. Y. 453; *Jones v. Guaranty, &c. Co.*, 101 U. S. 622; *Rochester Savings Bank v. Averell*, 96 N. Y. 467.

³ *Lord v. Yonkers Fuel Gas Co.*, 65 N. Y. 43.

⁴ 99 N. Y. 547. Compare *Carpenter v. Black Hawk Gold Mining Co.*, 65 *supra*.

fully dispose of as security for any debt which it may lawfully contract.¹

It has been held that a corporation may even pledge bonds² or shares of stock³ issued by itself, as security for its own debts. A transaction of this kind would in reality be a pledge of the power to issue the securities on non-payment of the debt, rather than a pledge of the securities themselves.⁴

The right of a corporation to pledge shares of its stock is subject to certain limitations which do not apply to the right of pledging property or negotiable certificates of indebtedness. It is a rule founded upon elementary principles, that shares in a corporation must not be declared paid up unless they have in fact been paid up, and that a corporation has no right, by any artifice, to put it out of its power to call in the full amount of its capital stock.⁵

A corporation may undoubtedly pledge shares which have once been fully paid up and have come back to the corporation, and may authorize the pledgee to sell the shares at any price. But if shares have never been issued or paid up, the corporation would have no right to give the pledgee the power to issue the shares or sell the certificates representing them, as fully paid up, for less than their par amount, unless the company's charter expressly authorizes it to declare its shares fully paid up on receiving payment of less than their amount.⁶

§ 350. **The Right of issuing Negotiable Obligations.** — In the United States it has been held, in accordance with the general rule governing the construction of charters,⁷ that corporations have implied authority to execute negotiable

¹ *Leo v. Union Pacific Ry. Co.*, 17 Fed. Rep. 273.

² *Combination Trust Co. v. Weed*, 2 Fed. Rep. 24.

³ *Lehman v. Tallassee Manuf. Co.*, 64 Ala. 567; *Androscoggin R. R. Co. v. Auburn Bank*, 48 Me. 335. See also *Duncomb v. N. Y. &c. R. R. Co.*, 84 N. Y. 190; *Chou-*

teau v. Allen, 70 Mo. 338. Compare *Kean v. Johnson*, 9 N. J. Eq. 401.

⁴ Compare *Burgess v. Seligman*, 107 U. S. 20; and see *infra*, § 830.

⁵ *Infra*, §§ 427, 761, 805.

⁶ See, however, to the contrary, *Peterborough R. R. Co. v. Nashua, &c. R. R. Co.*, 59 N. H. 385.

⁷ *Supra*, § 320.

promissory notes, whenever the use of commercial paper is appropriate as a means of accomplishing their chartered purposes. Willard, J., said, in delivering the opinion of the Court of Appeals of New York: "No question is better settled upon authority than that a corporation, not prohibited by law from doing so, and without any express power in its charter for that purpose, may make a negotiable promissory note payable either at a future day or on demand, when such note is given for any of the legitimate purposes for which the company was incorporated."¹

Upon the same principle it has been held that corporations have an implied right to draw and accept drafts and bills of exchange, and to execute other classes of commercial securities.²

A corporation has implied authority to indorse negotiable paper for any authorized purpose. And the power of indorsement may be exercised both for the purpose of transfer-

¹ *Moss v. Averell*, 10 N. Y. 449, 457. See also *Barker v. Mechanics' Ins. Co.*, 3 Wend. 94; *Moss v. Oakley*, 2 Hill, 265; *Safford v. Wyckoff*, 4 Hill, 442; *Moss v. Rossie Lead Mining Co.*, 5 Hill, 137; *Mott v. Hicks*, 1 Cowen, 513; *Clark v. Farmers', &c. Manuf. Co.*, 15 Wend. 256; *Kelley v. Mayor of Brooklyn*, 4 Hill, 263; *Munn v. Commission Co.*, 15 Johns. 44; *Barry v. Merchants' Exch. Co.*, 1 Sandf. Ch. 280; *Atty.-Gen. v. Life & Fire Ins. Co.*, 9 Paige, 470; *Mead v. Keeler*, 24 Barb. 20; *Partridge v. Badger*, 25 Barb. 146; *Central Bank v. Empire Stone, &c. Co.*, 26 Barb. 23; *Curtis v. Leavitt*, 15 N. Y. 9; *Olcott v. Tioga R. R. Co.*, 40 Barb. 179; 27 N. Y. 546; *Ketchum v. Buffalo*, 14 N. Y. 356; *Connecticut Mut. L. Ins. Co. v. Cleveland, &c. R. R. Co.*, 41 Barb. 9; *Mechanics' Banking Ass. v. N. Y., &c. White Lead Co.*, 35 N. Y. 505; *Monument Nat. Bank v. Globe Works*, 101 Mass. 57; *Fay v. Noble*, 12 Cush. 1; *Narragansett Bank v.*

Atlantic Silk Co., 3 Metc. (Mass.) 282; *Smith v. Eureka Flour Mills Co.*, 6 Cal. 1; *Magee v. Mokelumne Hill Canal, &c. Co.*, 5 Cal. 258; *Union Bank v. Jacobs*, 6 Humph. 515; *Richmond, &c. R. R. Co. v. Snead*, 19 Gratt. 354; *Oxford Iron Co. v. Spradley*, 46 Ala. 98; *Came v. Brigham*, 39 Me. 35; *Lucas v. Pitney*, 3 Dutch. 221; *Clarke v. School District*, 3 R. I. 199; *Re Great Western Tel. Co.*, 5 Biss. 363; *Straus v. Eagle Ins. Co.*, 5 Ohio St. 59; *McMasters v. Reed's Exrs.*, 1 Grant's Cas. 36; *Hamilton v. Newcastle, &c. R. R. Co.*, 9 Ind. 359; *Ward v. Johnson*, 95 Ill. 215, 238; *Millard v. St. Francis, &c. Academy*, 8 Bradw. 341; *Rockwell v. Elkhorn Bank*, 13 Wis. 653.

² *Hascall v. Life Ass.*, 5 Hun, 151; *Conro v. Port Henry Iron Co.*, 12 Barb. 27; *Olcott v. Tioga R. R. Co.*, 40 Barb. 179; 27 N. Y. 546; *Munn v. Commission Co.*, 15 Johns. 44; *Barnes v. Ontario Bank*, 19 N. Y. 152.

ring the legal title from the corporation,¹ and for the purpose of guaranteeing payment to the transferee.²

§ 351. In the United States a corporation has implied authority to issue negotiable paper for any legitimate purpose, although the issuing of negotiable paper may not be required under ordinary circumstances, in carrying on the kind of business in which the company is engaged. There is no difference in this respect between the issuing of negotiable paper and the making of contracts of any other class. Transactions which would not be in pursuance of the authorized purposes of a corporation, in the usual course of events, may be entirely proper under extraordinary circumstances. The use of negotiable paper is merely a means of accomplishing the chartered purposes of a corporation; and it is implied in the grant of a charter that the company may carry on its legitimate business in accordance with the usages of business men.

The question whether or not a contract executed on behalf of a corporation is of such a character that it might have been performed in pursuance of the legitimate business of the company under *ordinary* circumstances, is material only in determining the rights of parties dealing with the company in good faith and without notice. It is strictly a question of the law of agency. An inquiry into the authority of an agent executing a negotiable instrument or other contract is always in order; and in case of an agent of a corporation this involves an inquiry whether the agent acted for a purpose authorized by the company's charter, or a purpose in excess of it. A corporation is bound by an unauthorized act performed by an agent, only provided the act was within the apparent authority with which the agent was invested, and the person dealing with him had no notice that the act was in fact unauthorized.³

¹ Goodrich v. Reynolds, 31 Ill. 490; Hardy v. Merriweather, 14 Ind. 203; McIntire v. Preston, 10 Ill. 48; Frye v. Tucker, 24 Ill. 180; Buckley v. Briggs, 30 Mo. 452; Alexander v. Horner, 1 McCrary, 634.

² Railroad Co. v. Howard, 7 Wall. 412; Connecticut Mutual L. Ins. Co. v. Cleveland, &c. R. R. Co., 41 Barb. 9; Mechanics' Banking Ass. v. N. Y., &c. White Lead Co., 35 N. Y. 505. Compare *infra*, § 423.

³ *Infra*, § 565.

If the business of a corporation is of such a character as to require the issuing of negotiable paper under *ordinary* circumstances, a party receiving such paper in good faith and without notice, from an agent of the company having authority to issue it under ordinary circumstances, will be protected, although the agent may have acted without authority and in violation of the company's charter in the particular case.¹ But if the execution of negotiable instruments is not required in carrying on the legitimate business of a corporation except under *extraordinary* circumstances, a party receiving such paper is not entitled to assume the existence of those extraordinary circumstances, and must, at his peril, ascertain the real facts.²

§ 352. **The Rule in England.** — A different rule seems to be established in England. It is there held that a corporation has implied authority to issue negotiable instruments, provided its business be of such a character that the issuing of negotiable instruments would be an ordinary incident to it;³ but it seems that a corporation whose business does not require the issue of negotiable paper under ordinary circumstances has no implied authority to issue negotiable paper under any circumstances whatever.

In *Bateman v. Mid-Wales Ry. Co.*,⁴ Erle, C. J., said: "The question is whether this company, being a corporation created for the specific purpose of making a railway, can lawfully bind itself by accepting a bill of exchange. I am of opinion that it cannot. The bill of exchange is a cause of action, a contract by itself, which binds the acceptor in the hands of any indorsee for value; and I conceive it would be altogether contrary to the principles of law which regulate such instruments that they should be valid or not, according as the consideration between the original parties was good or bad, or whether, in case of a corporation, the consideration

¹ *Infra*, § 577.

² *Infra*, § 586.

³ *Re General Estates Co.*, L. R.

³ Ch. 758, 761, *per* Page-Wood,
L. J.; *Re Land Credit Co.*, L. R.

⁴ Ch. 460; *Bateman v. Mid-Wales Ry. Co.*, L. R. 1 C. P. 512, *per* Montague Smith, J.

⁴ L. R. 1 C. P. 499, 509, 512.

in respect of which the acceptance is given is sufficiently connected with the purpose for which the acceptors were incorporated. It would be inconvenient to the last degree if such an inquiry could be gone into. Some bills might be given for a consideration which was valid, as for work done for the company, and others as a security for money obtained on loan beyond their borrowing powers. It would be a pernicious thing to hold that in respect of the former the corporation might be sued by an indorsee, but in respect of the latter not."

In the same case, Montague Smith, J., said: "I am clearly of opinion that it was not within the competency of this company to accept bills. It is a company incorporated for the formation of a railway, with a limited capital and limited powers of borrowing money. If such a company had power to accept bills of exchange, the consequence would be either that they might bind themselves by acceptances to an unlimited extent, or there must in each case be an inquiry whether the bill was given for the payment of a just debt, or for a purpose not warranted by their incorporation."¹

Accordingly, it has been held in England that the right of issuing negotiable instruments could not be implied from the business of a railway company,² a mining company,³ a gas

¹ This argument carries too far; for the reasoning upon which it is founded would apply to contracts and transfers of property of every description. An inquiry into the authority of an agent executing a contract, whether it be negotiable or not, is always proper; and it is immaterial whether the principal be an individual or a corporation. *Infra*, Chapter VIII.

² *Bateman v. Mid-Wales Ry. Co.*, L. R. 1 C. P. 499. Compare *Peruvian Rys. Co. v. Thames, &c., Ins. Co.*, L. R. 2 Ch. 617.

The rule is different in the United States. See *Olcott v. Tioga R. R.*

Co., 40 Barb. 179; 27 N. Y. 546; *Lucas v. Pitney*, 27 N. J. Law, 221; *Richmond, &c. R. R. Co. v. Snead*, 19 Gratt. 354; *Union Bank v. Jacobs*, 6 Humph. 515; *Hamilton v. Newcastle, &c. R. R. Co.*, 9 Ind. 359; *Railroad Co. v. Howard*, 7 Wall. 412; and cases *supra*, § 350.

³ *Dickinson v. Valpy*, 10 B. & C. 128; *Brown v. Byers*, 16 M. & W. 252. Compare *Barrett's Case*, 4 De G., J. & S. 758.

In the United States, see *Moss v. Rossie Lead Mining Co.*, 5 Hill, 137; *Moss v. Averell*, 10 N. Y. 457.

company,¹ a water-works company,² a salt and alkali company,³ a cemetery company,⁴ or a salvage company.⁵

§ 353. **The Use of a Corporate Name.**—Corporations, like copartnerships, transact their business and are known to the world under particular names; but a corporation differs from a copartnership in this, that it is recognized by law, and must sue and be sued, as an entity, under the name by which it is known to the world.⁶

If a particular name is given to a corporation by its charter, this name should be used, and the use of any other name is unauthorized.⁷ But it seems that a corporation may acquire a new name by usage or reputation.⁸ If no name was given to a corporation by its charter, the right to adopt a name may be implied.⁹

§ 354. **The Effect of a Misnomer.**—The identity of a corporation is no more affected by a change of name, than the identity of an individual.¹⁰

The agents of a corporation have no implied authority to use any name except that indicated by the company's charter, in contracting on the company's behalf; but the use of a

¹ *Bramah v. Roberts*, 3 Bing. Co., 32 Ind. 376; *Regina v. Registrar*, 10 Q. B. 839.

² *Neale v. Turton*, 4 Bing. 149.

³ *Bult v. Morrell*, 12 A. & E. 745.

In the United States, manufacturing companies have a general authority to issue negotiable paper in regular course of business. See *Mott v. Hicks*, 1 Cowen, 513; *Clark v. Farmers', &c. Manuf. Co.*, 15 Wend. 256; *Mechanics' Banking Ass. v. N. Y., &c. White Lead Co.*, 35 N. Y. 505; *Smith v. Eureka Flour Mills Co.*, 6 Cal. 1; *Oxford Iron Co. v. Spradley*, 46 Ala. 98; *Monument Nat. Bank v. Globe Works*, 101 Mass. 57.

⁴ *Steele v. Harmer*, 14 M. & W. 831; 4 Exch. 1.

⁵ *Thompson v. Universal Salvage Co.*, 1 Exch. 694.

⁶ *Supra*, § 7.

⁷ *Glass v. Tipton Turnpike, &c.*

⁸ *Dutch West India Co. v. Moses*, 1 Stra. 614; *Knight v. Mayor of Wells*, 1 Ld. Raym. 80; *Smith v. Tallassee Plank Road Co.*, 30 Ala. 650; *Minot v. Curtis*, 7 Mass. 441; *South School District v. Blakeslee*, 13 Conn. 227. See *Melledge v. Boston Iron Co.*, 5 Cush. 158.

⁹ *Anonymous*, 1 Salk. 191. Compare *Pitts v. James*, Hob. 124; *Ayray's Case*, 11 Co. 19; *Johnson v. Common Council of Indianapolis*, 16 Ind. 227.

¹⁰ *Cahill v. Bigger*, 8 B. Monr. 211; *Rosenthal v. Madison, &c. Plank Road Co.*, 10 Ind. 358; *Northwestern College v. Schwagler*, 37 Iowa, 577. Compare *Episcopal Char. Soc. v. Episcopal Ch.*, 1 Pick. 372; *Dela-ware, &c. R. R. Co. v. Irick*, 3 Zab. 321. *Infra*, § 791.

wrong name is ordinarily not material, if the corporation is really intended by the parties. A misnomer of a corporation has the same legal effect as a misnomer of an individual. A contract entered into by a corporation, under an assumed name, may be enforced by either of the parties.¹ If the contract is expressed in writing, and the identity of the corporation can be ascertained from the instrument itself, the misnomer is wholly unimportant;² but, if necessary, other evidence may be introduced in order to establish what company was intended.³ The same rules apply to devises to corporations.⁴

If a notice is sufficient to serve its purpose, it will be sufficient in law, although it contain a misnomer.⁵ So, a statute or legal proceeding, relating to a corporation, is not inoperative by reason of a slight variation in the company's name, if the identity of the corporation is clearly indicated.⁶

§ 355. A misnomer of a corporation in pleading has the same legal effect as a misnomer of an individual under simi-

¹ *Hoboken Building Ass. v. Martin*, 2 Beasl. 427; *Boisgerard v. New York Banking Co.*, 2 Sandf. Ch. 23; *Hammond v. Shepard*, 29 How. Pr. 188, 191. Compare *Dutchess Cotton Manuf. Co. v. Davis*, 14 Johns. 238; *All Saints' Church v. Lovett*, 1 Hall, 191.

² *Mott v. Hicks*, 1 Cowen, 513; *Boisgerard v. New York Banking Co.*, 2 Sandf. Ch. 23; *Brockway v. Allen*, 17 Wend. 40; *Hoboken Building Ass. v. Martin*, 2 Beasl. 427; *Chadsey v. McCreery*, 27 Ill. 253; *Northwestern Distilling Co. v. Brant*, 69 Ill. 659; *Pitman v. Kintner*, 5 Blackf. 250; *Thatcher v. West River Nat. Bank*, 19 Mich. 196; *Ryan v. Martin*, 91 N. Car. 464; *Asheville Div. No. 15 v. Aston*, 92 N. Car. 578; *Clement v. City of Lathrop*, 18 Fed. Rep. 885.

³ *Medway Cotton Manufactory v. Adams*, 10 Mass. 360; *Franklin Avenue, &c. Savings Inst. v. Board*

of Education, 75 Mo. 408; *Melledge v. Boston Iron Co.*, 5 Cush. 158; *Milford, &c. Turnpike Co. v. Brush*, 10 Ohio, 111; *Kentucky Seminary v. Wallace*, 15 B. Monr. 35; *Berks, &c. Turnpike Co. v. Myers*, 6 S. & R. 12; *Hammond v. Shepard*, 29 How. Pr. 188.

⁴ *First Parish v. Cole*, 3 Pick. 232; *Minot v. Boston Asylum, &c.*, 7 Metc. (Mass.) 416; *New York Institution, &c. v. How*, 10 N. Y. 84; *Button v. American Tract Soc.*, 23 Vt. 336; *Vansant v. Roberts*, 3 Md. 119; *Chapin v. School District*, 35 N. H. 445; *Preachers' Aid Soc. v. Rich*, 45 Me. 552; *Atty.-Gen. v. Mayor*, 7 Taunt. 546.

⁵ *Eastham v. Blackburn Ry. Co.*, 23 L. J. Exch. 199; *Gray v. Monongahela Nav. Co.*, 2 W. & S. 156.

⁶ *Chancellor of Oxford's Case*, 10 Co. 54, 57 b; *Souhegan Nail, &c. Co. v. McConihe*, 7 N. H. 309.

lar circumstances. Suits should be brought by and against parties by their proper names. But a misnomer of the plaintiff in an action must be pleaded in abatement in the United States, as was formerly the rule in England ;¹ and the same rule applies in case of a misnomer of the defendant.²

If a corporation has been misnamed in an obligation made in its favor, the company should bring suit against the obligor in its right name ;³ but if the *obligor* of a bond or deed be misnamed, it seems that, at common law, he should be sued by such assumed name, and not by his proper name.⁴

The Code of Civil Procedure of New York provides that, "In an action or special proceeding brought by or against a corporation, the defendant is deemed to have waived any mistake in the statement of the corporate name, unless the misnomer is pleaded in the answer, or other pleading in the defendant's behalf."⁵

§ 356. **The Implied Right to sue and be sued.** — The distinguishing characteristic of a corporation is, that it is recognized by law as a collective body. Partnerships usually act like collective bodies in their business transactions, but they are not recognized by law in that character ; and the rights of the several partners or members must be worked out directly, upon common law principles, without the intervention of the company or united body, as a representative of their joint interests. In this fact, and the consequences which result therefrom, lies the fundamental distinction between a

¹ 1 Chitty on Pl. 451 (6th ed.); Mayor of Stafford v. Bolton, 1 B. & P. 40; Hoereth v. Franklin Mill Co., 30 Ill. 157; State v. Bell Telephone Co., 36 Ohio St. 296. Compare Burnham v. Savings Bank, 5 N. H. 446.

² Gilbert v. Nantucket Bank, 5 Mass. 97; Stone v. Berkshire Cong. Soc., 14 Vt. 86; School District v. Griner, 8 Kans. 224; Lake Sup. Build. Co. v. Thompson, 32 Mich. 293; State v. Bell Telephone Co., 36 Ohio St. 296; Wilson v. Baker, 52 Iowa,

423. Compare Virginia, &c. Nav. Co. v. United States, Taney, 418.

³ Northwestern Distilling Co. v. Brant, 69 Ill. 658; New York African Soc. v. Varick, 13 Johns. 38; Alloways Creek Township v. String, 5 Halst. 323; Commercial Bank v. French, 21 Pick. 486; Berks, &c. Turnpike Co. v. Myers, 6 S. & R. 12.

⁴ 1 Chitty on Pl. 245 (6th ed.).

⁵ Code of Civil Procedure, § 1777; Whittlesey v. Frantz, 74 N. Y. 456; Methodist, &c. Church v. Tryon, 1 Denio, 451.

corporation and a copartnership.¹ To be recognized by law as a collective body is, therefore, essential to the legal existence of a corporation; and it is necessarily implied in the grant of every charter of incorporation, that the company may sue and be sued in a corporate capacity, without regard to the individual members who compose the company, whenever the corporate property or rights are involved.

§ 357. Remedies available to a Corporation. — A corporation may avail itself of any legal or equitable remedy which would be available to an individual under similar circumstances. Thus, a corporation may sue like an individual upon express or implied promises. It may obtain a writ of right, and prosecute real and possessory actions;² and it may sue its tenants for use and occupation whenever an individual might sue in that form of action.³ A corporation which has rendered salvage services through its agents may sue in admiralty as a salvor.⁴ So a corporation may sue out a commission in bankruptcy as petitioning creditor;⁵ and it may agree to a reference to arbitrators.⁶

Corporations are impliedly authorized to sue in chancery whenever their equitable rights are involved. Thus, a corporation may apply for an injunction to prevent other persons from using its name, to the injury of its trade.⁷ So a corporation may, by injunction, restrain the commission of a nuisance upon its property;⁸ and, in a proper case, it may maintain a bill of interpleader.⁹

It has been held that a corporation cannot at common law be an administrator or executor, for the duties of an admin-

¹ See *supra*, § 7.

² 1 Kyd on Corp. 185; Gospel Soc. v. Wheeler, 2 Gall. 126.

³ Mayor of Stafford v. Till, 4 Bing. 75.

⁴ The Camanche, 8 Wall. 448; The Blackwall, 10 Wall. 1.

⁵ *Ex parte* Bank of England, 1 Swanst. 10.

⁶ Alexandria Canal Co. v. Swann, 5 How. 89; Day v. Essex County Bank, 13 Vt. 97. Compare Sawyer

v. Winnegance Mill Co., 26 Me. 122; Paret v. City of Bayonne, 39 N. J. Law, 559.

⁷ Newby v. Oregon, &c. Ry. Co., Deady, 609; Holmes v. Holmes, &c. Manuf. Co., 37 Conn. 278. Compare London, &c. Law Assur. Soc. v. London, &c. Ins. Co., 11 Jurist, 938.

⁸ Central Bridge Co. v. Lowell, 4 Gray, 474.

⁹ Salisbury Mills v. Townsend, 109 Mass. 115.

istrator or executor are of a personal nature, and cannot be delegated to an agent;¹ but there are numerous instances in which corporations have been expressly empowered by statute to administer estates.

§ 358. Personal injuries cannot, in the nature of things, be suffered by a corporation aggregate; but a corporation may sue for loss of service or other pecuniary damage resulting from personal injuries to its servants. And a corporation may by the usual remedies recover damages for every kind of wrong which it can suffer.

Corporations are not confined to suits for damages to their tangible property, as by action of trespass or trover; but they may also sue for consequential damages caused by loss of profits in their business. Thus, a corporation may sue on account of a libel or slander concerning its business or property; and an allegation of special damages is not necessary in such case, if it would not be necessary in a suit of similar character brought by an individual.² So a corporation may maintain an action on the case on account of a vexatious suit brought against it.³

§ 359. **The Territorial Limits within which a Corporation may act.**—It has sometimes been said, that a corporation must reside in a particular place, and that it cannot migrate from the State which created it to another State.⁴ Expressions of this kind are mere figures of speech, and cannot be made the basis of intelligent argument.

It is true that the meetings of the shareholders in a corporation must be held at some fixed place, even though no

¹ *Georgetown College v. Browne*, 34 Md. 450; *Re Thompson's Estate*, 33 Barb. 334.

In England it is held that, if a corporation be named executor, it may appoint an individual to receive administration in its place. 1 Williams on Exrs. 229.

² *Metropolitan, &c. Omnibus Co. v. Hawkins*, 4 H. & N. 87; *Trenton, &c. Ins. Co. v. Perrine*, 3 Zab. 402;

Shoe & Leather Bank v. Thompson, 23 How. Pr. 253; *Knickerbocker Life Ins. Co. v. Ecclesine*, 42 How. Pr. 201; s. c. 34 N. Y. Super. Ct. 76; *Hahnemannian Life Ins. Co. v. Beebe*, 48 Ill. 87. Compare *Brennan v. Tracy*, 2 Mo. App. 540.

³ Compare *South Royalton Bank v. Suffolk Bank*, 27 Vt. 505.

⁴ See *State v. Milwaukee, &c. Ry. Co.*, 45 Wis. 579.

express provision to that effect be contained in their charter;¹ and it is evident that a corporation cannot extend its franchises from the jurisdiction of the sovereignty which granted them, to the jurisdiction of a sovereignty which did not grant them.² But it is not true that there is any technical rule of law restricting a corporation in its transactions to a particular area or territory. The extent of the territory within which a corporation may carry on its operations depends entirely upon the nature of the business in which the corporation is engaged; and if there is no express provision in the charter of a corporation, limiting it in its ordinary business transactions to a particular place or territory, no such limitation is to be implied. The rule is, that a corporation is impliedly authorized by its charter to carry on its business both at home and abroad, through the usual agencies, in the same manner as a copartnership engaged in a similar enterprise. The *right* to carry on the business of a corporation in a foreign State undoubtedly depends upon the consent of that State; but this consent is almost universally accorded as a matter of comity.³

§ 360. It has been held, in accordance with these views, that a corporation chartered for the purpose of carrying on the business of banking may engage in legitimate banking operations in the territory of any State which gives its consent. In *Bank of Augusta v. Earle*, Chief Justice Taney said: "The charter of the Bank of Augusta authorizes it in general terms to deal in bills of exchange, and consequently gives it the power to purchase foreign bills as well as inland; in other words, to purchase bills payable in another State. The power thus given clothed the corporation with the right to make contracts out of the State, in so far as Georgia could confer it. For whenever it purchased a foreign bill, and forwarded it to an agent for acceptance, if it was honored by the drawee, the contract of acceptance was necessarily made in another State; and the general power to purchase bills, without any restriction as to place,

¹ *Infra*, § 468.

³ *Infra*, § 940.

² *Infra*, § 939.

by its fair and natural import authorized the bank to make such purchases wherever it was found most convenient and profitable to the institution; and also to employ suitable agents for that purpose. The purchase of the bill in question was, therefore, the exercise of one of the powers which the bank possessed under its charter; and was sanctioned by the law of Georgia creating the corporation, so far as that State could authorize a corporation to exercise its powers beyond the limits of its own jurisdiction.”¹

It has frequently been held that railroad companies,² and insurance companies,³ may establish agencies, and enter into contracts in foreign States, in the prosecution of the enterprises for which they were chartered; and the same rule undoubtedly applies to all other classes of corporations.

Corporations may acquire and hold real and personal property, wherever this is found convenient in the prosecution of their authorized purposes, subject, of course, to the laws in force where the property is situated. And although a corporation may not have authority to purchase lands in a foreign State, for purposes of speculation, it may nevertheless be authorized to receive the property in satisfaction of a valid debt.⁴

The cases above referred to are cited merely to illustrate, and not to define, the general rule, that corporations are impliedly authorized by their charters to carry on business in the customary manner, wherever this is found most convenient and profitable. The territory within which a cor-

¹ *Bank of Augusta v. Earle*, 13 Pet. 588; *Williams v. Creswell*, 51 Miss. 817; *Hadley v. Freedman's Savings, &c. Co.*, 2 Tenn. Ch. 122; *Silver Lake Bank v. North*, 4 Johns. Ch. 370. Compare *People v. Oakland County Bank*, 1 Dougl. (Mich.) 282; *Atty.-Gen. v. Oakland County Bank*, Walk. (Mich.) 90.

² See *McCluer v. Manchester, &c. R. R. Co.*, 13 Gray, 124.

³ *Kennebec Co. v. Augusta Ins., &c. Co.*, 6 Gray, 204; *Liverpool*

Ins. Co. v. Massachusetts, 10 Wall. 567, 573; *Bard v. Poole*, 12 N. Y. 498; *Western v. Genesee Mutual Ins. Co.*, 12 N. Y. 258; *Mumford v. American Life Ins., &c. Co.*, 4 N. Y. 463.

⁴ *Thompson v. Waters*, 25 Mich. 227, 232; *Lathrop v. Commercial Bank*, 8 Dana, 114; *New York Dry Dock Co. v. Hicks*, 5 McL. 111; *National Trust Co. v. Murphy*, 30 N. J. Eq. 408; *Cincinnati, &c. R. R. Co. v. Pearce*, 28 Ind. 502.

poration must confine its operations is determined by the nature of its business, and not by the political boundaries between States.¹

§ 361. In *State v. Milwaukee, &c. Ry. Co.*,² the Supreme Court of Wisconsin expressed an opinion that it is the duty of every private corporation to keep its principal place of business and its records so located as to render it accessible to the process and to the exercise of the visitatorial power of the State by which it is chartered. This doctrine is correct only provided the legislature has expressed the policy of the State by some special enactment, or by a general system of legislation regarding incorporated companies; there is no such rule at common law. It is always implied in the grant of a charter of incorporation, where there is no indication to the contrary, that the company shall have its central office or place of management in the State under whose laws it was organized. This, however, is merely a rule applicable to the construction of charters, in determining the intention of the corporators and of the State, and is not an arbitrary rule of law.

In some instances it has been provided, in general incorporation laws, that a majority of the directors of a company incorporated under the laws shall be residents of the State. In the absence of a provision of this description, there is no rule requiring the directors and officers, any more than the corporators forming the company, to reside within the State.³ The directors may even hold their meetings out of the State.⁴ However, a corporation cannot be formed in one State for the purpose of evading the laws of another State; to attempt this would be an abuse of the comity extended by the States to foreign corporations.⁵

¹ *New York Floating Derrick Co. v. New Jersey Oil Co.*, 3 Duer, 648; *Walter A. Wood, &c. Co. v. Caldwell*, 54 Ind. 270.

As to statutory regulations governing foreign corporations, see *infra*, §§ 641-645.

² *State v. Milwaukee, &c. Ry. Co.*, 45 Wis. 579.

³ *Humphreys v. Mooney*, 5 Col. 282. See *State v. Milwaukee, &c. Ry. Co.*, 45 Wis. 579. *Supra*, § 35.

⁴ *Infra*, § 513.

⁵ *Infra*, § 945.

PART II.

§ 362. **What Transactions are authorized.—General Principles.**—It is a well-established general rule, that a corporation may carry on the business for which it was chartered in the manner in which a business of that particular kind is usually carried on. What the usual manner of carrying on a business is cannot be determined by the application of purely legal principles; it is a question of fact, and not a question of law. Evidently, therefore, it is impossible to decide abstractly that acts of a particular description are within or without the chartered powers of a corporation. The right of a corporation to perform an act depends, in every case, upon all the surrounding circumstances; no act is authorized under all circumstances, and facts can be conceived which would render almost any act justifiable. Thus, a railroad company may usually buy coal and material for constructing its road, but it would have no authority to buy coal or anything else as a speculation, with the intention of selling it again.¹ On the other hand, it would clearly be unauthorized, under any ordinary state of facts, to use the funds of a railroad company for building a church or a theatre; yet this use of the corporate funds might be entirely justifiable, if a church or a theatre were required for the use of the company's workmen, in a part of the world where no church or suitable place of recreation was accessible.²

No rules can be framed which would be of any practical value in determining cases of this character. The most that can be done is to state the general principles which have influenced the courts in their decisions, and to illustrate these general principles by examples. The application of the law to individual cases must always remain a matter involving the exercise of sound practical judgment and business experience.

¹ *Infra*, § 393.

² See *infra*, § 589.

Great caution is therefore necessary in treating a decision that a corporation has or has not authority to do a particular act, as a precedent to be followed in other cases. Such a decision would not establish an absolute rule, which could be applied mechanically; but all the facts and the general principles by which the court was guided in reaching its conclusion must always be considered. It is important also to bear in mind, that the fact that a transaction of a corporation has been sustained by a court does not necessarily prove that the corporation had a right to enter into it. There are many instances in which the courts will disregard the illegality of a transgression by a corporation of its chartered powers, in order to do justice between the parties.¹

§ 363. *Profitableness of a Transaction not the Test.*—The fact that a transaction is profitable to a corporation is not alone sufficient to show that it is within its chartered powers. The ultimate object of every business corporation is the gain of money, but this object must be attained by the particular means indicated by the company's charter. To employ other means would be contrary to the agreement of the shareholders, and in excess of the authority granted by the State. Charters must be construed in the light of custom. Such transactions as are customary or usual in the prosecution of a business of the kind in which a corporation is engaged, are impliedly authorized by its charter; but a corporation has no right to engage in any transaction which is not in pursuance of the particular enterprise described in its charter. The same rule of construction is applicable to articles of copartnership.²

In *Central R. R. Co. v. Collins*,³ a portion of the shareholders in a railroad company obtained an injunction to restrain the corporation from purchasing a large amount of the stock of another company, for the purpose of controlling its management. McCay, J., delivering the opinion of the

¹ *Infra*, §§ 628–634.

² *Hood v. New York, &c. R. R. Co.*, 22 Conn. 1, 16, 17; *Atty.-Gen. v. Great Eastern Ry. Co.*, L. R.

11 Ch. D. 480, 481, *per James, L. J.*

³ *Central R. R. Co. v. Collins*, 40 Ga. 582–617.

court, said: "We do not think the profitableness of this contract to the stockholders of the Central and Southwestern Railroad Company has anything to do with the matter. These stockholders have a *right*, at their pleasure, to stand on their contract. If the charters do not give to these companies the *right* to go into this new enterprise, any one stockholder has a right to object. He is not to be forced into an enterprise not included in the charter. That it will be to his interest is no excuse; that is for him to judge. By becoming a stockholder he has contracted that a majority of the stockholders shall manage the affairs of the company within its proper sphere as a corporation, but no further; and any attempt to use the funds or pledge the credit of the company, not within the legitimate scope of the charter, is a violation of the contract which the stockholders have made with each other, and of the *rights*—*the contract rights*—of any stockholder who chooses to say, 'I am not willing.' It may be that it will be to his advantage, but he may not think so, and he has a legal right to insist upon it that the company shall keep within the powers granted to it by the charter."¹

§ 364. **Transactions collateral to the Main Purposes of a Corporation.**—Business corporations are formed for the pecuniary profit of their shareholders. Economy is, therefore, essential in the proper management of the corporate affairs; and it is implied in the charter of every corporation of this character, that it may adopt all such means as will enable it to attain its legitimate purposes in the most profitable manner. A transaction may *prima facie* appear to be wholly foreign to the business for which a corporation was formed; and yet, if it be auxiliary to any legitimate purpose of the company, and adapted to attain the same more advantageously, it is impliedly authorized.

The considerations which influence the courts in passing upon questions of this character were stated clearly by Lord Romilly, in *Lyde v. Eastern Bengal Ry. Co.* In that case,

¹ See also *Beman v. Rufford*, *First Bryan Bapt. Church*, 63 Ga. 1 Sim. N. S. 564; *Harriman v.* 186, 195.

a motion was made for an injunction to restrain the officers of a railway company from operating a steamboat line and applying the company's funds to that purpose. The defendants insisted that the use of a steamboat was warranted by the nature of the company's business; and, as an illustration of the manner in which a railway company might legitimately embark in projects apparently inconsistent with its means and objects, it was suggested that a railway company might properly work a coal-mine, if by so doing it could obtain coals more cheaply than by purchasing them; and that it would be foolish, in such case, to prevent the company from obtaining a profit by the sale of such coals as were raised but not required for the use of the company. The Master of the Rolls said: "The answer to this argument appears to me to depend upon the facts of each particular case. If, in truth, the real object of the colliery was to supply the railway with cheaper coals, it would be proper to allow the accidental additional profit of selling coals to others; but if the principal object of the colliery was to undertake the business of raising and selling coals, then it would be a perversion of the funds of the company, and a scheme which ought not to be permitted, however profitable it might appear to be. The prohibition or permission to carry on this trade would depend on the conclusions which the court drew from the evidence. The same observations apply here: if the use of the boat is really to assist the traffic of the existing railway, it is lawful and proper; but if the object be to extend the traffic to places beyond the railway, which the railway is never intended to reach, then it is illegal and beyond the powers of the company."¹

§ 365. **A Corporation may adapt itself to Changes of Time and Circumstances.** — A corporation has implied authority to conduct its business upon liberal principles. It may generally do whatever an intelligent man would do under similar circumstances. Hence, it is implied in the formation of every

¹ *Lyde v. Eastern Bengal Ry. Co.*, & Bl. 397, 415, 443; *Atty.-Gen. v. 36 Beav. 16, 17.* See also *Mayor of Great Eastern Ry. Co.*, L. R. 11 *Norwich v. Norfolk Ry. Co.*, 4 El. Ch. D. 480, 481, 505.

business corporation that it shall adapt itself to changes of time and circumstances; and that it may avail itself of any new appliances or inventions which are deemed necessary or convenient to a successful prosecution of its business. Under these circumstances there is no departure from the original agreement of the corporators, although the latter could not possibly have contemplated the alterations which time and events have brought about. The members of a corporation all agree that its business shall be carried on in the usual manner. Very few of the transactions of a business corporation can be anticipated at its formation. Yet they are within the agreement of the shareholders, because it is understood that the company's business shall be managed in the customary way; and, for the same reason, it follows that a corporation may extend its business and adapt itself to altered circumstances, so long as it remains true to its original purposes.

Thus, a manufacturing company may adopt new machinery and buy a patent right, in order to be able to compete successfully with other parties engaged in a similar business.¹

A canal company may widen and deepen its canal, and a railroad company may enlarge the carrying capacity of its road, in order to meet the requirements of an increase of traffic.² There can be no doubt that railroad companies may adopt all improvements in their business which a liberal management and inventive genius can provide.³

§ 366. In *Dupee v. Boston Water Power Co.*,⁴ the Supreme Court of Massachusetts held that a corporation chartered for the purpose of creating water power by erection of dams might release its water privileges after they

¹ *Re British, &c. Cork Co. (Leif-child's Case)*, L. R. 1 Eq. 231; *Chicago, &c. R. R. Co. v. Wilson*, 17 Ill. 123.
² *Gleadow v. Hull Glass Co.*, 19 L. J. Ch. 44; *Dorsey, &c. Rake Co. v. Marsh*, 6 Fish. Pat. Cas. 387.
³ *Mayor of Norwich v. Norfolk Ry. Co.*, 4 El. & Bl. 397, 433.
⁴ *Dupee v. Boston Water Power Co.*, 114 Mass. 37, 43, 44.

² *Selden v. Delaware, &c. Canal Co.*, 29 N. Y. 634; *Atlantic, &c.*

could no longer be profitably used; that it might thereupon enter into arrangement to sell its lands, receiving shares of its own stock in payment at a certain valuation; and that it might agree to raise the grade of the lands as an inducement to the purchasers. Colt, J., said: "Regard must be had to the peculiar situation of the property. The increase of population since the original act of incorporation has given greatly increased value to the lands acquired by the company. The business of the company can no longer be profitably confined to the development and use of its water privileges. It has, by contract with the Commonwealth, the city, and other owners of lands, extinguished its water power, and now owns instead thereof extensive and valuable tracts of lands, over which it had originally only the right to flow. This change in its business has made it necessary to fill in and improve the land, that it might be available as assets of the company; and this necessity has been recognized by a resolve of the legislature authorizing an increase of capital for that purpose.

"There is nothing in the general laws of the Commonwealth, or in the company's charter, which forbids the sale proposed. The power to purchase and hold implies the power to sell, and to sell upon such terms as to secure the highest price. . . . We cannot see that the rights of any of the stockholders will be illegally prejudiced by the proposed receipt of the shares in payment for its land. Nor is there anything unreasonable in an agreement of the corporation to fill up lands so sold to the usual grade, made at the time of the sale as an inducement to their purchase, and as one way to make the most profitable disposition of the property. The power to make such an agreement is implied in the power to sell."

§ 367. *The Disposition of Surplus Property.* — Under the most skilful management of the affairs of a corporation, it may happen at times that a portion of its fixtures or other property cannot be made available in prosecuting the principal business for which the company was formed. Under these circumstances, it is clearly for the benefit of all those

who are interested in the welfare of the corporation that its property be employed in the most profitable manner possible, even though not for the purposes for which it was acquired. A prudent business man would not allow his capital to lie idle under similar circumstances.

Thus, a steam-ferry company may own a larger number of vessels than are required in the prosecution of its regular business at any particular time; it may be advisable to hold additional vessels in reserve for cases of emergency or accident. But it is not necessary that the vessels held in reserve be kept idle. The company may temporarily lease them to other parties, or may use them itself for any purpose for which they are suitable, such as the towage of vessels or the transportation of passengers and merchandise, provided such use be merely temporary and incidental to the principal business of the company.¹ So a railway company having authority to keep steam vessels for the purposes of a ferry may use such vessels for excursion trips when not otherwise employed.²

The principle of these cases was affirmed by the House of Lords in *Simpson v. Westminster Palace Hotel Co.*³ It was there held that a company which had been established for the purpose of building and managing a hotel and tavern, and which had erected a much larger building than it could use at first before its business was created, might temporarily lease a large portion of the building to the head of a government department for offices. Lord Chelmsford said: "I am satisfied that this arrangement will be highly beneficial to the shareholders, and will aid rather than obstruct the objects of the undertaking, while it appears to me quite clear that it does not interfere with the general principle upon which the undertaking is based."

¹ *Brown v. Winnisimmet Co.*, 11 Allen, 326.

² *Forrest v. Manchester, &c. Ry. Co.*, 30 Beav. 40.

³ *Simpson v. Westminster Palace Hotel Co.*, 8 H. L. Cas. 712. See

also *City Hotel v. Dickinson*, 6 Gray, 586; *French v. Quincy*, 3 Allen, 9; *Horsey's Claim*, L. R. 5 Eq. 561; *Lafond v. Deems*, 81 N. Y. 507; *Temple Grove Seminary v. Cramer*, 98 N. Y. 121.

In *Featherstonhaugh v. Lee Moor, &c. Co.*,¹ Vice-Chancellor Page-Wood held that a mining company had implied authority to lease the whole of its mines, works, and buildings for twenty-one years, for the reason that it could not at the time use them profitably itself. The decision was based upon the principle which was acted upon in *Simpson v. The Westminster Hotel Co.*; but it may be doubted whether other considerations should not have controlled.²

Upon the same principle it has been held that companies may temporarily lend their surplus funds on safe security, when it is inexpedient to distribute them among the shareholders.³

§ 367 *a.* **Further Authorities in Illustration of the preceding Sections.**—The principles indicated in the preceding sections have been applied in a great variety of cases arising under diverse circumstances.

Thus, it has been held that a company newly incorporated for the purpose of manufacturing and selling glass, after having purchased the business and fixtures of a former company engaged in the same trade, might rightfully contract for a stock of goods in order to enable it to continue the business regularly, and thus retain the customers of the old company while the machinery was undergoing repairs.⁴

It has been held that a railway company might agree to construct a carriage-road and wharf in consideration of a release from a more onerous engagement;⁵ and that a corporation might undertake the performance of a trust wholly foreign to its chartered purposes provided the trust was charged upon a legacy the substantial part of which was for the company's benefit.⁶

It has been held that a corporation owning a large body of lands, and having authority "to aid in the development of

¹ L. R. 1 Eq. 318, 329.

² See *infra*, §§ 412, 415, 416.

³ *Commissioners v. Atlantic, &c. R. R. Co.*, 77 N. Car. 289.

⁴ *Lyndeborough Glass Co. v. Massachusetts Glass Co.*, 111 Mass. 315.

⁵ *Wilson v. Furness Ry. Co.*, L. R. 9 Eq. 28.

⁶ *In the Matter of Howe*, 1 Paige, 214.

minerals and other materials in and upon the lands, and to promote the clearing and settlement of the country," could rightfully build saw-mills and a hotel for the accommodation of those having business with the company.¹ A manufacturing company may, under certain circumstances, open a shop for supplying its laborers with necessities, and may carry on the shop in the usual manner of retail trade.² And a turnpike company may lease land and build a house for the shelter of its servants and for storing the implements used in its business.³ It has been held, that a mining company may, without being expressly authorized by its charter, purchase a steamboat, or provide other means of transportation, for the purpose of carrying its minerals to the market and delivering them to purchasers;⁴ and a similar rule has been applied to a lumber company.⁵

§ 368. **Railroad Companies.**—Railroad companies have implied authority to build docks, elevators, and warehouses for the storage of property transported or to be transported on their roads, and workshops for the manufacture and repair of machinery; they may keep horses and trucks for the delivery of freight, and may make all other arrangements for the proper and convenient management of their business.⁶ They are also impliedly authorized to provide refreshment and dining rooms, book-stalls, omnibuses, and otherwise secure the comfort and convenience of travellers.⁷ Railroad companies

¹ *Watts's Appeal*, 78 Pa. St. 370, 392.

² *Dauchy v. Brown*, 24 Vt. 197; *Searight v. Payne*, 6 Lea, 283.

³ *Crawford v. Longstreet*, 43 N. J. Law, 325.

⁴ *Calloway Mining, &c. Co. v. Clark*, 32 Mo. 305; *Moss v. Averell*, 10 N. Y. 449, 456.

⁵ *Gruber v. Washington, &c. R. R. Co.*, 92 N. Car. 1.

⁶ *New York, &c. R. R. Co. v. Kip*, 46 N. Y. 546; *Western Union Telegraph Co. v. Rich*, 19 Kans. 517; *Moses v. Boston, &c. R. R. Co.*, 24 N. H. 71, 82; *Smith v. Nashua, &c.*

R. R. Co., 27 N. H. 86, 95; *Cother v. Midland Ry. Co.*, 2 Phill. 469; *East & West India Docks, &c. Ry. Co. v. Dawes*, 11 Hare, 363.

⁷ *Flanagan v. Great Western Ry. Co.*, L. R. 7 Eq. 116; *Shrewsbury, &c. Ry. Co. v. Stour Valley Ry. Co.*, 2 De G., M. & G. 866; *Holmes v. Eastern Counties Ry. Co.*, 3 K. & J. 675; *Atty.-Gen. v. Great Eastern Ry. Co.*, L. R. 11 Ch. D. 505, *per* Bramwell, L. J. See *Railroad Commissioners v. Portland, &c. R. R. Co.*, 68 Me. 269. It has been held that a railroad company may contract for the construction

have no implied authority to become trading companies, or to speculate in lands, coal, grain, or other property.¹ But they may always dispose of their surplus property, or such property as cannot be profitably used by them. Companies which have received land grants from the government may take measures to attract settlers, by building townships and providing other inducements; they may also dispose of the land upon such terms as they deem most profitable.

§ 369. **Acquisition of Land by Railroad Companies.**—Railroad companies are usually incorporated for the purpose of constructing certain lines of railroad, and operating them when completed; and they are enabled by statute to acquire the necessary land and rights of way, by exercise of the right of eminent domain. The extent to which the right of eminent domain can be exercised by a company depends upon the constitutional limits of this right,² and upon the terms of the statute by which the legislature has delegated it.

A grant to a company of the right to use the power of eminent domain for the purpose of building a railroad, by implication confers the right of taking such land as is necessary for the safe and convenient construction of the company's tracks, turn-outs, side-tracks,³ bridges, and embankments,⁴ and all the necessary appurtenances of a properly constituted railroad, such as stations, engine-houses,⁵ repair shops,⁶ warehouses for freight,⁷ cattle yards for live cattle,⁸ a telegraph line,⁹ etc.

of a hotel near its station. *Texas, &c. R. R. Co. v. Robards*, 60 Tex. 545. As to what accessories are included in a mortgage of a "railroad," see *Morgan v. Donovan*, 58 Ala. 241, 260.

¹ *Infra*, § 394.

² *Infra*, § 1067.

³ *Cleveland, &c. R. R. Co. v. Speer*, 56 Pa. St. 325; *Toledo, &c. Ry. Co. v. Daniels*, 16 Ohio St. 390.

⁴ *Reusch v. Chicago, &c. R. R. Co.*, 57 Iowa, 687.

⁵ *Re New York, &c. R. R. Co.*, 77 N. Y. 248.

⁶ *Hannibal, &c. R. R. Co. v. Muder*, 49 Mo. 165; *Virginia, &c. R. R. Co. v. Elliott*, 5 Nev. 358; *Low v. Galena, &c. R. R. Co.*, 18 Ill. 324.

⁷ *Re New York, &c. R. R. Co.*, 77 N. Y. 248; *New York, &c. R. R. Co. v. Kip*, 46 N. Y. 546; *Hannibal, &c. R. R. Co. v. Muder*, 49 Mo. 165.

⁸ *New York, &c. R. R. Co. v. Metropolitan Gas Light Co.*, 63 N. Y. 326.

⁹ *Prather v. Jeffersonville, &c. R. R. Co.*, 52 Ind. 16.

§ 370. **Delegated Power of Eminent Domain not commensurate with Power to purchase.** — The right of a railroad company to take property by exercise of the power of eminent domain is not commensurate with the right of obtaining property by purchase. A railroad company may *purchase* any property which is convenient in the management of its business, and the property so obtained may have no immediate connection with the use and operation of the railroad itself. Thus, a railroad company may purchase land and establish offices in distant places for the convenience of those dealing with it; it may buy shops for the manufacture of materials, and mines for the production of coal;¹ it may build dwelling-houses for its operatives, and, in general, may acquire any property which is convenient for the construction or use of the company's road and the development of its business, according to the usual manner of railroad companies.²

But this cannot be done by exercise of the power of eminent domain. Property can be appropriated under the power of eminent domain only provided two conditions concur. First, the property must be of such a description that the company cannot safely be left to acquire it by purchase only. It is for this reason that the power of eminent domain usually extends only over land or fixed property. Rails, ties and spikes, engines, cars, coals, oil, lamps, and many other articles, are necessary for the construction and use of a railroad, yet these things can always be obtained by purchase, and cannot be taken under the power of eminent domain.³ Secondly, only such property can be taken as is necessary for the construction and operation of the railroad itself. Property which

¹ *Per* Lord Romilly, in *Lyde v. Eastern Bengal Ry. Co.*, 36 Beav. 16, 17. Compare *Atty.-Gen. v. Great Northern Ry. Co.*, 1 Dr. & Sm. 154; s. c. 6 Jurist, n. s. 1006.

² *Spear v. Crawford*, 14 Wend. 20, *Black v. Delaware, &c. Canal Co.*, 7 Q. E. Green, 410; *Blackburn v. Selma, &c. R. R. Co.*, 2 Flipp. 525. See cases in the following notes; also *supra*, § 368.

In *Old Colony R. R. Co. v. Evans*, 6 Gray, 25, the court held that a purchase by a railroad company of land upon its line of road, for the purpose of selling gravel taken from the land and transporting it, was not unauthorized.

³ *Eldridge v. Smith*, 34 Vt. 484, 493.

is not immediately connected with the road must be obtained by purchase. Thus, a railroad company cannot use the power of eminent domain to take land for building a wharf,¹ or for shops at which to manufacture railroad cars,² or for the dwellings of operatives,³ or for offices in town, or for any other similar purpose,⁴ yet it may purchase land for any of these purposes.

§ 371. **How a Railroad Company may obtain its Railroad.** — Railroad companies have implied authority to enter into such financial arrangements as are necessary to obtain the means of constructing, equipping, and operating their lines of road. The right to borrow money and issue bonds and negotiable paper, is clearly implied;⁵ but it has been held that a railroad company cannot mortgage its line of road, unless expressly authorized by the legislature.⁶

A railroad company is entitled to obtain its railroad in the most economical manner which is consistent with the obligations imposed by the company's charter. It may obtain its right of way by exercise of the power of eminent domain, or by purchase or compromise upon such terms as are most favorable.⁷ If a bridge is needed for the convenience of the company's traffic, it may buy one already built, answering the required purposes.⁸ And there can be no doubt that railroad companies are in many instances authorized to purchase or lease lines of road constructed by other companies, or to make such traffic arrangements as are deemed advantageous.

§ 372. The right of a railroad company to purchase or lease a line of road already constructed, or to make arrangements for the use of another company's tracks, depends upon

¹ *Iron R. R. Co. v. Ironton*, 19 Ohio St. 299.

² *New York, &c. R. R. Co. v. Kip*, 46 N. Y. 546; 6 Hun, 24.

³ *Eldridge v. Smith*, 34 Vt. 484.

⁴ *New York, &c. R. R. Co. v. Gunnison*, 1 Hun, 496; *Rensselaer, &c. R. R. Co. v. Davis*, 43 N. Y. 137; *State v. Mansfield*, 3 Zab. 510. See *Proprietors, &c. v. Nashua, &c. R. R. Co.*, 104 Mass. 1.

⁵ *Savannah, &c. R. R. Co. v. Lancaster*, 62 Ala. 555; *Branch v. Atlantic, &c. R. R. Co.*, 3 Woods, 481. *Supra*, § 350.

⁶ *Infra*, § 1020.

⁷ *Wilson v. Furness Ry. Co.*, L. R. 9 Eq. 28.

⁸ *Thompson v. New York, &c. R. R. Co.*, 3 Sandf. Ch. 626; *Moss v. McCullough*, 7 Barb. 279.

the circumstances of the case. The objects for which the company was formed must be considered. If a company is chartered for the purpose of *constructing and operating* a new railroad between given points, different from any existing line, it would be a departure from the charter to buy or lease a road already built between the two points.¹ If, however, the company should be able to form the line of road contemplated by its charter by constructing part of it, and using a road already built to complete the line, there is no reason why it should not do so. The ultimate purpose of an ordinary railroad company is, not to build a railroad, but to carry on the business of common carrier by operating a railroad. If the company can obtain just the line of road which its charter calls for by purchase, lease, or gift, every reason of policy indicates that it should be allowed to do so rather than to compel it to go to the unnecessary and wasteful expenditure of constructing a new railroad.²

§ 373. **The Construction of Branch Roads and Extensions.** — A railroad company has ordinarily no right to build branches or extensions from the line of road laid out in its charter, unless there be some provision expressly authorizing this to be done.³ But this rule is not without exception. Thus, if it should prove advantageous to build the line of a railroad company a short distance away from a town which the company would be entitled to reach, the construction of a short branch connecting the town with the railroad would be entirely proper. Cases of this kind must be viewed liberally; it should be borne in mind that the main purpose of a railroad is to obtain traffic, and provide the public with means of transportation.

¹ See *Lamb v. Anderson*, 54 Iowa, 190; *Lawrence v. Smith*, 57 Iowa, 701.

² *Branch v. Atlantic, &c. R. R. Co.*, 3 Woods, 481; affirmed as *Branch v. Jesup*, 106 U. S. 468, 484, 486; *Stockton, &c. R. R. Co. v. Stockton*, 51 Cal. 328. Compare *State v. Beck*, 81 Ind. 500.

A railroad company may un-

doubtedly cause its railroad to be constructed by an independent contractor, having full control over the work. *Hughes v. Railway Co.*, 39 Ohio St. 461.

³ See *Works v. Junction R. R. Co.*, 5 McLean, 425; *Baltimore, &c. Turnpike Co. v. Union R. R. Co.*, 35 Md. 224.

Where the right to build branches and extensions is expressly granted, the exercise of this right depends largely upon the discretion of the company or its agents. But a branch road or extension must remain subsidiary to the main line; it cannot be made the principal thing, and the main line a mere addition.¹

§ 374. **Purchase of Steamboats and other Conveyances.**—A railroad company may provide stage-coaches, and other means of conveyance between stations along its road and neighboring towns and villages.² Upon the same principle, it has been held that a railroad company may establish a line of steamboats to connect the terminus of its road, at a river or other navigable body of water, with other railroads or centres of trade.³

But each case of this character depends upon its peculiar circumstances. A railroad company has no right to become a steamboat company; nor can it make the transportation of passengers and merchandise over other roads its principal business. The implied right of a railroad company to extend its business to distant points is merely incidental to the right of operating its own line of road in the most advantageous manner.⁴

§ 375. **Railroad Companies may contract to carry Freight and Passengers beyond the Limits of their Roads.**—It is well settled that railroad companies have implied authority to make contracts for the transportation of merchandise to points beyond the limits of their own lines; and that they

¹ *Platteville v. Galena, &c. R. R. Co.*, 43 Wis. 493.

² *Buffett v. Troy, &c. R. R. Co.*, 40 N. Y. 168; 36 Barb. 420.

³ *South Wales Ry. Co. v. Redmond*, 10 C. B. N. s. 675; *Shawmut Bank v. Plattsburgh, &c. R. R. Co.*, 31 Vt. 491; *Wheeler v. San Francisco, &c. R. R. Co.*, 31 Cal. 46. See also *Lyde v. Eastern Bengal Ry. Co.*, 36 Beav. 16; *Camblos v. Philadelphia, &c. R. R. Co.*, 4 Brewster, 563, 604, 605. Compare *Illinois*

Central R. R. Co. v. Irvin, 72 Ill. 452, 455.

⁴ *Colman v. Eastern Counties Ry. Co.*, 10 Beav. 1; *Gregory v. Patchett*, 33 Beav. 595, 606; *Hare v. London, &c. Ry. Co.*, 2 J. & H. 80, 106; *Hoagland v. Hannibal, &c. R. R. Co.*, 39 Mo. 451; *Camblos v. Philadelphia, &c. R. R. Co.*, 4 Brewster, 563, 604; *Pearce v. Madison, &c. R. R. Co.*, 21 How. 441. See *Lyde v. Eastern Bengal Ry. Co.*, 36 Beav. 16.

may become liable for the safe carriage of the property to the place of its destination.¹ Similar contracts made for the transportation of passengers and their luggage are of daily occurrence, and have repeatedly been held to be authorized.²

This rule is based upon the requirements of commerce and public convenience. In *Perkins v. Portland, &c. R. R. Co.*,³ the Supreme Court of Maine said: "Upon a careful survey of all the authorities, we are satisfied that a railroad company may be bound by a special contract to transport persons or property beyond the line of their own road. In granting the charter, all incidental powers which are necessary to the proper and profitable exercise of those which are

¹ *Railroad Co. v. Pratt*, 22 Wall. 123; *Railway Co. v. McCarthy*, 96 U. S. 258; *Burtis v. Buffalo, &c. R. R. Co.*, 24 N. Y. 269; *Buffett v. Troy, &c. R. R. Co.*, 40 N. Y. 168; 36 Barb. 420; *Maghee v. Camden, &c. R. R. Co.*, 45 N. Y. 514; *Root v. Great Western R. R. Co.*, 45 N. Y. 524; *Milnor v. New York, &c. R. R. Co.*, 53 N. Y. 363; *Darling v. Boston, &c. R. R. Co.*, 11 Allen, 295; *Hill Manuf. Co. v. Boston, &c. R. R. Co.*, 104 Mass. 122; *Feital v. Middlesex R. R. Co.*, 109 Mass. 398; *Baltimore, &c. Steamb. Co. v. Brown*, 54 Pa. St. 77; *Camblos v. Philadelphia, &c. R. R. Co.*, 4 Brewster, 563, 604; *Cincinnati, &c. R. R. Co. v. Pontius*, 19 Ohio St. 221; *Illinois Central R. R. Co. v. Copeland*, 24 Ill. 332; *Field v. Chicago, &c. R. R. Co.*, 71 Ill. 458; *Toledo, &c. Ry. Co. v. Lockhart*, 71 Ill. 627; *Nashua Lock Co. v. Worcester, &c. R. R. Co.*, 48 N. H. 339; *Wheeler v. San Francisco, &c. R. R. Co.*, 31 Cal. 46; *Grover & Baker S. M. Co. v. Missouri Pac. Ry. Co.*, 70 Mo. 672; *Morse v. Brainerd*, 41 Vt. 550; *Stewart v. Erie, &c. Transp. Co.*, 17 Minn. 372; *Bryan v. Memphis, &c. R. R. Co.*,

11 Bush, 597; *Candee v. Pennsylvania R. R. Co.*, 21 Wis. 582; *Muligan v. Illinois Central Ry. Co.*, 36 Iowa, 181; *East Tenn., &c. R. R. Co. v. Rogers*, 6 Heisk. 143; *Louisville, &c. R. R. Co. v. Campbell*, 7 Heisk. 253; *Wilby v. West Cornwall Ry. Co.*, 2 H. & N. 703.

A different rule has been enforced in Connecticut; but it seems probable that the courts of that State will ultimately accept the prevailing doctrine. See *Converse v. Norwich, &c. Transp. Co.*, 33 Conn. 166; *Hood v. New York, &c. R. R. Co.*, 22 Conn. 1, 502; *Elmore v. Naugatuck R. R. Co.*, 23 Conn. 457; *Naugatuck R. R. Co. v. Waterbury Button Co.*, 24 Conn. 468.

² *Croft v. Baltimore, &c. R. R. Co.*, 1 MacArthur, 492; *Kessler v. New York Central R. R. Co.*, 7 Lans. 63; 61 N. Y. 538; *Burnell v. New York Central R. R. Co.*, 45 N. Y. 184; *Wilson v. Chesapeake, &c. R. R. Co.*, 21 Gratt. 654; *Illinois Central R. R. Co. v. Copeland*, 24 Ill. 332; *Candee v. Pennsylvania R. R. Co.*, 21 Wis. 582.

³ *Perkins v. Portland, &c. R. R. Co.*, 47 Me. 573, 590.

specially enumerated may be presumed to be conferred by implication. The business of common carriers between different places is intimately interwoven, branching off into innumerable channels. And it is often of great public convenience, if not of absolute necessity, that several companies should combine their operations, and thus transport passengers and merchandise, by a mutual arrangement, over all their lines, upon one contract for one price."

§ 376. **Traffic Arrangements between Railroad Companies.**—The right of a railroad company to make contracts for the transportation of freight and passengers beyond the limits of its own line of road, necessarily implies a right to enter into arrangements with other carriers for the regulation of through traffic, and the apportionment of the income derived therefrom.

It is often difficult, in practice, to determine whether a traffic arrangement between two companies is authorized by their charters or not. Each case must depend largely upon all the peculiar circumstances surrounding it; but the general principles which govern are clear. A railroad corporation cannot enter into any arrangement amounting to a practical consolidation or copartnership, nor can it delegate any of its statutory powers, to another company, whether by a sale, a lease, or a mere license, unless expressly authorized by law.¹ It is also settled that the enterprise for the prosecution of which a corporation was formed cannot be extended beyond the limits fixed by the company's charter.² All corporations, however, have implied authority to enter into contracts for the purpose of attaining their legitimate objects; and accordingly railroad companies may make any reasonable arrangements with each other, for the purpose of regulating and increasing their legitimate joint traffic.³

Thus, it has been held that railroad companies owning connecting lines may, by contracts between each other, fix

¹ *Infra*, §§ 396, 421, 910.

² *Infra*, § 392.

³ *Stewart v. Erie, &c. Transportation Co.*, 17 Minn. 386-395. With

regard to pooling contracts and traffic arrangements between competing lines, see *infra*, § 1130.

the time of running trains, and the rates to be charged upon through transportation. "The companies may agree, as individuals may agree, to certain rates of transportation, which may be considered mutually advantageous. Neither company has parted with its corporate powers; each acts for itself, and under its own powers in fixing the rates of transportation, and they both agree that the charge shall be uniform throughout the line."¹

Agreements between companies owning connecting lines, providing for a division between them of all their earnings derived from joint traffic, upon fixed proportions, are authorized;² and an agreement of this kind may be valid, although a larger portion of the joint earnings be given to one company than is in proportion to the work which it has done.³

§ 377. Railroad companies have implied authority to enter into contracts with each other to maintain connection between their several lines of road; and an attempt by either company to sever the connection agreed upon, by changing the gauge of its road, may be restrained by a court of chancery.⁴ Under the proper circumstances, several companies may even join in constructing a connecting road, and may agree that it shall be operated upon certain prescribed conditions for their joint benefit.⁵

Two railroad companies, whose roads form a continuous

¹ *Columbus, &c. R. R. Co. v. R. R. Co.*, 19 N. J. Eq. 13; s. c. *Indianapolis, &c. R. R. Co.*, 5 McL. 20 N. J. Eq. 542.
450; *Stewart v. Erie, &c. Transportation Co.*, 17 Minn. 372.

² *Munhall v. Pennsylvania R. R. Co.*, 92 Pa. St. 150; *Stewart v. Erie, &c. Transportation Co.*, 17 Minn. 372; *Hartford, &c. R. R. Co. v. New York, &c. R. R. Co.* 3 Robertson, 411; *Arnot v. Erie Ry. Co.*, 5 Hun, 610; *Hare v. London, &c. Ry. Co.*, 2 J. & H. 80. Compare *Fitchburg, &c. R. R. Co. v. Hanna*, 6 Gray, 539; *Lancaster, &c. Ry. Co. v. Northwestern Ry. Co.*, 2 K. & J. 301, 302.

³ *Sussex R. R. Co. v. Morris, &c.*

Arrangements of this kind do not create a partnership between the contracting companies. *Irvin v. Nashville, &c. Ry. Co.*, 92 Ill. 103.
⁴ *Columbus, &c. R. R. Co. v. Indianapolis, &c. R. R. Co.*, 5 McL. 450; *Androscoggin, &c. R. R. Co. v. Androscoggin R. R. Co.*, 52 Me. 417. Compare *Beman v. Rufford*, 1 Sim. n. s. 569; *Sussex R. R. Co. v. Morris, &c. R. R. Co.*, 19 N. J. Eq. 13; s. c. 20 N. J. Eq. 542.

⁵ Compare *Bartlette v. Norwich, &c. R. R. Co.*, 33 Conn. 560.

line, may by mutual agreement regulate their joint traffic, and appoint a common manager to act for both; but they cannot enter into a copartnership.¹

§ 378. **Agreements between Railroad Companies for Running Powers.**—Agreements between railroad companies, by which one company is given the right to use the tracks, stations, and other fixtures belonging to another company, are very common in practice; and there can be no doubt that such agreements are impliedly authorized under certain circumstances. Before the validity of an agreement of this character can be determined, in any given case, it is necessary to consider two distinct questions depending upon different facts. These are:—

First. Had the company giving up the use of its tracks and other property the right to do so?

Secondly. Had the company obtaining the running powers authority by its charter to extend its business over the line of the other company?

§ 379. **When such Agreements are authorized on the Part of the Lessor.**—It is clear that a corporation, chartered for the purpose of constructing a railroad and operating it as a common carrier for hire, is not impliedly authorized to act as a construction company merely, and to build a railroad for the use of another company; nor has a railroad company implied authority to cease prosecuting its business as common carrier, and, instead, to lease its road to another company.² But a railroad company, like any other company whose object is the gain of money, may make the most profitable use which it can of its surplus property, and may sometimes apply such surplus property to uses entirely disconnected from the main enterprise for which the company was chartered.³ If, then, a railroad company should not be able to utilize all of its running facilities in the prosecution of its own business, it may properly lease the surplus to another company.

¹ *State v. Concord R. R. Co.*, 13 Am. & Eng. R. R. Cas. 94. Compare *Burke v. Concord R. R. Co.*, 8 Am. & Eng. R. R. Cas. 554.

² *Infra*, § 1020. As to the rule in New York, see *Woodruff v. Erie Ry. Co.*, 93 N. Y. 609.

³ *Supra*, § 367.

There is no reason why the tracks, stations, and other property belonging to a railroad company, should lie idle while they may be profitably employed.

The case of *Midland Ry. Co. v. Great Western Ry. Co.*¹ is a strong illustration of this doctrine. It was there held that a corporation owning a short line of road, which could not be used profitably except in connection with other lines, might, under the circumstances, make a contract with another company, giving the latter the right to use the whole of the railroad, and the appurtenances belonging to it, upon certain specified terms.

§ 380. **When authorized on the Part of the Lessee.**—A railroad company, whose charter authorizes it to operate a particular line of road, has no implied authority to operate a different road. Nor can the enterprise of a company be varied from that authorized by its charter, by purchase or lease of the road of another company.² And for the same reasons it follows that a corporation cannot make a contract for running powers over the line of another company, if this would extend its own business beyond the limits authorized by law.³

But the ultimate object for which railroad companies are formed is to carry on the business of common carriers, and not to construct railroads. And it has frequently been held that corporations are impliedly authorized to prosecute their enterprises, and obtain their legitimate objects, in the most economical manner possible.⁴ Hence, if a railroad company, authorized by its charter to do business as carrier between two given points, can perform its duties as carrier with equal facility, and at a saving of cost, by obtaining the right to run its trains over a road belonging to another

¹ *Midland Ry. Co. v. Great Western Ry. Co.*, L. R. 8 Ch. 841, 858. See also *Atty.-Gen. v. Great Eastern Ry. Co.*, L. R. 11 Ch. Div. 449. Reg. N. S. 733; *London, &c. Ry. Co. v. London, &c. Ry. Co.*, 4 De G. & J. 362, 389; *Simpson v. Denison*, 10 Hare, 51. Compare *Richmond Water Works Co. v. Vestry of Richmond*, L. R. 3 Ch. D. 98.

² *Infra*, § 394.

³ *Ohio &c. R. R. Co. v. Indianapolis, &c. R. R. Co.*, 5 Am. L.

⁴ *Supra*, §§ 364-368.

company, there is no good reason why it should not be allowed to do so.¹

§ 381. **A Railroad Company should operate its Road by its Regular Agents.**—A company chartered for the purpose of operating a railroad should operate the road in the usual manner and by the usual agencies. It follows, therefore, that a railroad company has no implied authority to make an agreement with a contractor that the latter shall manage all the traffic upon the road, and furnish the motive power. Such an arrangement, if carried out, would release the agents of the company from the charge of the most important part of the company's business.²

§ 382. **The Banking Business.**—The business of banking has been carried on for many years according to certain well-understood customs; the general nature of these customs will be judicially noticed by the courts.³ When an association is incorporated for the purpose of doing a banking business, it is implied that it may carry on business in the customary manner, unless restrained by its charter or a general statute.

§ 383. **Banks may borrow and lend Money.**—The right of carrying on the banking business in the usual manner necessarily involves the right of borrowing and lending money. All incorporated banks may borrow and lend money, in the regular course of banking, unless expressly restrained by their charters. The right to borrow includes the right to execute a bond, note, or other evidence of indebtedness, and to give security by pledge or mortgage.⁴

¹ *Midland Ry. Co. v. Great Western Ry. Co.*, L. R. 8 Ch. 841; *Naugatuck R. R. Co. v. Waterbury Button Co.*, 24 Conn. 468, 482; *Bartlette v. Norwich, &c. R. R. Co.*, 33 Conn. 560; *Great Northern Ry. Co. v. Manchester, &c. Ry. Co.*, 5 De G. & S. 138. *Supra*, § 391.

² *Per* Lord Justice Turner, in *Johnson v. Shrewsbury, &c. Ry. Co.*, 3 De G., M. & G. 930.

³ *Bank of Australasia v. Breillat*, 6 Moore P. C. 173, *per* Lord Campbell, C. J.; *Pattison v. Syracuse Nat. Bank*, 80 N. Y. 82. As to the implied powers of the ordinary agents of banks, see *infra*, §§ 318, 319.

⁴ *Ward v. Johnson*, 95 Ill. 215; *Curtis v. Leavitt*, 15 N. Y. 9.

The right of banks to lend money is frequently regulated and restricted by express provisions, contained in their charters and the general laws. But loans can in no case be made outside of the course of legitimate banking business, or in an irregular manner.

§ 384. **National Banks.** — The National Banking Act provides that no person or company shall at any time be indebted to any corporation formed under the act for a sum exceeding one tenth part of the capital of the corporation actually paid in.¹ It also provides that no national bank shall make any loan or discount on the security of shares of its own stock,² or upon the security of real estate.³

Loans made in violation of either of these provisions are necessarily illegal, and in excess of the powers conferred upon the agents of any bank organized under the act; but it does not follow, as a consequence, that such loans must be declared void in all cases, and be held unenforceable in favor of either of the parties.⁴

By the express provisions of the act, the prohibitions against receiving shares of stock or real estate as security do not apply where they are received in good faith to prevent loss upon a debt previously contracted. It is held that the renewal of promissory notes, or the extension of the time of payment of a debt, is not the creation of a new indebtedness within the meaning of the act.⁵

¹ R. S. § 5200. See *Bank v. Lanier*, 11 Wall. 369; *Allen v. First National Bank*, 23 Ohio St. 97; *National Bank v. Paige's Exr.*, 53 Vt. 452. *Infra*, § 653.

² R. S. § 5201. See *Conklin v. Second Nat. Bank*, 45 N. Y. 655; *Bank v. Lanier*, 11 Wall. 369; *Bullard v. Bank*, 18 Wall. 589; *Re Bigelow*, 1 Bankr. Reg. 667; *Evansville Nat. Bank v. Metropolitan Nat. Bank*, 2 Biss. 527; *Second Nat. Bank v. National State Bank*, 10 Bush, 367.

³ R. S. § 5137. See *Kansas Valley Nat. Bank v. Rowell*, 2 Dill. 371;

Allen v. First Nat. Bank, 23 Ohio St. 97; *Merchants' Nat. Bank v. Mears*, 8 Biss. 158; *Ornn v. Merchants' Nat. Bank*, 16 Kans. 341; *Upton v. National Bank*, 120 Mass. 153; *New Orleans Nat. Bank v. Raymond*, 29 La. Ann. 355; *Third Nat. Bank v. Blake*, 73 N. Y. 260; *First Nat. Bank v. Haire*, 36 Iowa, 443; *Scofield v. State Nat. Bank*, 9 Neb. 316. See *National Bank v. Matthews*, 98 U. S. 621, and cases *infra*, § 653, as to the effect of unauthorized loans.

⁴ *Infra*, § 653.

⁵ *Shinkle v. First Nat. Bank*, 22

§ 385. National banks are expressly authorized by law to carry on the business of banking, "by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt;¹ by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes."

The right of "loaning money on personal security" includes the right of receiving personal property as collateral security, according to the usual practice in the banking business. Mr. Justice Dillon said: "National banks are not, in my judgment, confined, in the taking of security for discounts and loans, to the security afforded by the names of indorsers or personal sureties, but may take a pledge of bonds, choses in action, bills of lading, or other personal chattels. The words 'loans on personal security' in the banking act are used in contradistinction to real estate security."²

It has been held that the right of discounting and negotiating negotiable paper does not include the right of buying and selling it, and that a purchase by a national bank of negotiable paper is unauthorized.³

It has also been held that a national bank has no right to act as broker in disposing of securities for other parties.⁴

§ 386. **What Property Banks may acquire.**—Banking corporations have implied authority to acquire and hold such

Ohio St. 516; *Howard Nat. Bank v. Loomis*, 51 Vt. 349; *National Bank v. Paige's Exr.*, 53 Vt. 452.

¹ This includes the right of dealing in checks. *First Nat. Bank v. Harris*, 108 Mass. 514.

² *Pittsburg Locomotive, &c. Works v. State Nat. Bank* (U. S. C. C.), 2 Cent. L. J. 692. See also *Shoemaker v. National Mech. Bank*, 2 Abb. U. S. C. C. 416; *Baldwin v. Canfield*, 26 Minn. 43; *Third Nat. Bank v. Boyd*, 44 Md. 47.

³ *Lazear v. National Union Bank*, 52 Md. 78; *First National Bank v.*

Pierson, 24 Minn. 140; *Weckler v. First National Bank*, 42 Md. 581; *Farmers', &c. Bank v. Baldwin*, 23 Minn. 198. But compare *Smith v. Exchange Bank*, 26 Ohio St. 141; *Atlantic State Bank v. Savery*, 82 N. Y. 291; *First National Bank v. Harris*, 108 Mass. 514; *Thatcher v. West River Nat. Bank*, 19 Mich. 196.

⁴ *First Nat. Bank v. Hoch*, 89 Pa. St. 324; s. c. 9 Reporter, 153; *First Nat. Bank v. National Exchange Bank*, 92 U. S. 122; *Fowler v. Scully*, 72 Pa. St. 456.

property as is necessary, for the convenient transaction of their business.¹ Thus, they may purchase or erect suitable buildings, and may provide office furniture, books, and other appliances, for the accommodation of their agents and the management of their affairs. The right to acquire real estate for the purpose of establishing a proper place of business, or banking-house, is sometimes conferred by express provision.²

Banking corporations have no implied authority to deal in real estate, or any other kind of property, as this is not incidental to the prosecution of an ordinary banking business.³ But they may receive real estate and other property in satisfaction of debts, or as collateral security, if this be done in good faith to prevent a loss,⁴ even though they be expressly prohibited from buying and selling the property or dealing in it.⁵ In many instances, the right to receive mortgages or conveyances of real estate in satisfaction of debts previously contracted is conferred by express provision.⁶

§ 387. **Place of Business of a Banking Corporation.** — Banking corporations have implied authority to create agencies for special purposes, such as the redemption and purchase of bills of exchange and other securities, wherever this may be advantageous in carrying on their business;⁷ but they have no right to establish branch banks in the absence of express authority conferred by charter. When a banking corporation is created to do business at some particular place, it is

¹ See *supra*, § 327.

² See *Banks v. Poitiaux*, 3 Rand. 136; *Metropolitan Bank v. Godfrey*, 23 Ill. 579; *Thomaston Bank v. Stimpson*, 21 Me. 195.

³ *First Nat. Bank v. National Exchange Bank*, 39 Md. 600; *Weckler v. First Nat. Bank*, 42 Md. 581; *First Nat. Bank v. National Exchange Bank*, 92 U. S. 122, 128; *Thweatt v. Bank of Hopkinsville*, 81 Ky. 1.

⁴ *First Nat. Bank v. National Exchange Bank*, 92 U. S. 122;

Third Nat. Bank v. Boyd, 44 Md. 47.

⁵ See *supra*, § 321. *Sacket's Harbor Bank v. Lewis County Bank*, 11 Barb. 213.

⁶ *Baird v. Bank of Washington*, 11 S. & R. 411. See *National Banking Acts*.

⁷ *City Bank v. Beach*, 1 Blatchf. 425; *Bank of Augusta v. Earle*, 13 Pet. 519; *Tombigbee R. R. Co. v. Kneeland*, 4 How. 16. See *supra*, § 359; *contra*, *People v. Oakland County Bank*, 1 Dougl. (Mich.) 282.

implied that its banking-house shall be established at that place only, and that its affairs shall be managed by a single set of officers, in the usual manner.

§ 388. **Special Deposits, etc.** — The receipt of money, bullion, securities, and other valuables, on special deposit, appears to be incidental to the management of a bank according to the general usages of the banking business.¹ It has been held, therefore, that incorporated banking companies have implied authority, unless prohibited by their charters, to receive special deposits for safe keeping, either gratuitously or for a consideration.² The right of national banks to receive special deposits is settled by an adjudication of the Supreme Court of the United States.³

There seems to be no doubt that a bank may receive money on general deposit as a stakeholder, and agree to pay it over according to the terms of an agreement, or in pursuance of definite instructions.⁴

§ 389. **Collections. — Accommodation Indorsements.** — All banks have implied authority to collect notes, checks, and bills of exchange, and to transmit them to their business correspondents for that purpose; this constitutes an important branch of the banking business.⁵ It has been held that national banks have implied authority to undertake to exchange non-registered government bonds for registered bonds.⁶

¹ See *Pattison v. Syracuse Nat. Bank*, 80 N. Y. 94.

² *Ibid.*, 82, and authorities cited. *Foster v. Essex Bank*, 17 Mass. 479; and see cases in the following note.

As to the authority of particular agents to receive special deposits, see *infra*, § 540.

³ *First Nat. Bank v. Graham*, 100 U. S. 699. *Contra*, *Wiley v. First Nat. Bank*, 47 Vt. 546; *Whitney v. First Nat. Bank*, 50 Vt. 388. Compare *Chattahoochee Nat. Bank v. Schley*, 58 Ga. 369; *Lancaster County Nat. Bank v. Smith*, 62 Pa. St. 47; *Scott v. Nat. Bank*, 72 Pa. St.

471; *First Nat. Bank v. Graham*, 79 Pa. St. 106; *First Nat. Bank v. Rex*, 89 Pa. St. 308; *Turner v. First Nat. Bank*, 26 Iowa, 562; *Smith v. First Nat. Bank*, 99 Mass. 605; *First Nat. Bank v. Ocean Nat. Bank*, 60 N. Y. 278; *Third Nat. Bank v. Boyd*, 44 Md. 47; *Wylie v. Northampton Nat. Bank*, 15 Fed. R. 428.

⁴ Compare *Bushnell v. Chataqua County Nat. Bank*, 10 Hun, 378.

⁵ *Yerkes v. National Bank*, 69 N. Y. 382.

⁶ *Ibid.*; *Van Leuven v. First Nat. Bank*, 54 N. Y. 671; *Leach v. Hale*, 31 Iowa, 69.

Banks may indorse negotiable paper, and guarantee the payment of debts for a consideration, and in the regular course of the banking business,¹ but they have no right to execute indorsements, or lend their credit for accommodation, or in any unauthorized transaction.²

§ 390. **Savings Banks. — Their Nature.** — Savings banks differ radically from ordinary banks. They are not formed for the profit of their shareholders, but for the benefit of those who deposit their money in them.

In *Huntington v. Savings Bank*,³ Justice Strong defined a savings bank as follows: "It is not a commercial partnership, nor is it an artificial being the members of which have property interests in it, nor is it strictly eleemosynary. Its purpose is rather to furnish a safe depository for the money of those members of the community disposed to intrust their property to its keeping. It is somewhat of the nature of such corporations as church-wardens for the conservation of the goods of a parish, the college of surgeons for the promotion of medical science, or the society of antiquaries for the advancement of the study of antiquities. Its purpose is a public advantage, without any interest in its members."

In *Tappan v. Warren Savings Bank*,⁴ the Supreme Court of Massachusetts said: "The chief business of a savings bank is to receive deposits, invest them in certain classes of securities, specified in the statutes of the Commonwealth, and to pay to depositors the amount due them, either in whole or in part, as they from time to time demand. It has no authority to do a general banking business, not even to engage in the business of discounting bank paper. It is no part of the business for which it is established, to give a market value to, or obtain a market value for, the negotiable paper of persons or other corporations, by guaranteeing or indorsing it."

¹ See *Peoples' Bank v. National Bank*, 101 U. S. 181.

³ *Huntington v. Savings Bank*, 96 U. S. 388, 394.

² *Seligman v. Charlottesville Nat. Bank*, 3 Hughes, 647; *Johnston v. Same, Id.*, 657; *National Bank v. Welles*, 15 Hun, 51. *Infra*, § 423.

⁴ *Bradlee v. Warren, &c. Savings Bank*, 127 Mass. 107, 109.

§ 391. **Rights of Depositors.** — The depositors in a savings bank, organized upon the usual plan, are the beneficial owners of the entire corporate estate. The legal title to this estate is in the corporation, as an entity, and full powers of management are vested in the corporate officers and agents; but the affairs of the corporation must be managed in the interest of the depositors, and not in the interest of the shareholders, or corporators, as in case of an ordinary banking company.

The rights of the depositors in a savings bank are of a twofold character. While the corporation is solvent and in operation, the depositors may be regarded solely in the light of creditors of the corporation; they may withdraw their deposits, and claim interest, as provided in the charter and by-laws, and may enforce their rights by the usual remedies at law. But the depositors are in reality something different from ordinary creditors. They are in reality joint beneficiaries of the corporate estate, and occupy a position similar to that of the stockholders in an ordinary corporation. The courts will recognize the true position of the depositors, as they do the true position of shareholders, whenever this becomes necessary for the protection and adjustment of their equitable rights.

Accordingly, it has been held that, if a depositor in a savings bank is indebted to the corporation, and the corporation becomes insolvent, he will not be allowed to set off the amount of his deposit against the claim of the corporation, but must pay the amount of his debt in full, and take a dividend with the other depositors, upon the distribution of the assets of the corporation.¹

The profits of an ordinary savings bank, after deducting the expenses of managing it, inure wholly to the benefit of the depositors, and must be distributed as dividends, or reserved as a surplus for their greater security.²

¹ *Stockton v. Mechanics', &c. Savings Bank*, 32 N. J. Eq. 163, 166, 167; and see *infra*, § 621.

² *Huntington v. Savings Bank*, 96 U. S. 388.

Whether the profits of a savings bank, when distributed among the depositors, be called "interest," or "dividends," is purely a question of definition. As a matter of fact,

§ 392. **A Corporation has no Implied Authority to engage in Transactions outside of its Chartered Purposes.**—A corporation has no implied authority to engage in any transaction which is not in pursuance of the particular business for which it was chartered. It is a reasonable presumption that the founders of a corporation intended that the company's business should be carried on in the usual manner and by the usual means, unless they have expressly provided the contrary. A transaction which is not in pursuance of the chartered purposes of a corporation, or which is unusual as a means of attaining those purposes, cannot be deemed to be impliedly authorized by the company's charter.¹ It is to be borne in mind, that the right of a corporation to do an act depends upon all the circumstances of the case. A decision that an act performed by a corporation under a given state of facts was unauthorized, does not establish that a similar act would be unauthorized if performed under other circumstances. The authorities relating to the powers of corporations are of no value, except as illustrations of the general principles which should be followed.²

§ 393. **Illustrations.**—It is well settled that a corporation cannot engage in a business wholly distinct from its main enterprise, merely in order to raise funds for the purpose of carrying on the latter;³ nor is a transaction authorized merely because it is profitable to the corporation.⁴

Thus, it has been held that a coal mining company cannot buy coals in the market as a speculation;⁵ and a company chartered to build a toll bridge cannot under ordinary cir-

the money distributed among the depositors is the profit on their investment of their own money, and is in all material respects similar to the dividends paid to the shareholders of an ordinary corporation.

In *Van Dyck v. McQuade*, 86 N. Y. 38, the word "dividends," as used in various statutes, was held not to apply to the money distributed

among the depositors of a savings bank.

¹ *Supra*, §§ 316, 320, 363.

² *Supra*, § 362.

³ *Waldo v. Chicago, &c. R. R. Co.*, 14 Wis 575; *Clark v. Farrington*, 11 Wis. 306.

⁴ *Supra*, § 363.

⁵ *Alexander v. Cauldwell*, 83 N. Y. 480.

cumstances construct a wharf and rent it, without departing from its chartered purposes.¹

A life or fire insurance company has no implied authority to issue marine policies;² nor can a life and accident insurance company insure against loss by fire.³

A company incorporated for the purpose of manufacturing and selling railway carriages, and other materials for the construction and use of railways, and "to carry on the business of general contractors," cannot lawfully purchase a concession to build a railway in a foreign country, and contract to build the same through the medium of a foreign company.⁴ And it is clear that a mining and manufacturing company cannot be transformed into a railroad company, without a departure from its chartered purposes.⁵ So a corporation which was not created for banking purposes has no authority to do a banking business, by loaning its funds.⁶

It has been held that a corporation chartered to make a road, take tolls, and build hotels, for the accommodation of travellers, could not establish a stage line and carry the mails.⁷

§ 394. **Railroad Companies.**—A railroad company has no right to purchase land, merely to prevent a rival company from obtaining it, or for purposes of speculation and sale;⁸ nor can a railway company trade in coals,⁹ or become a

¹ Toll Bridge Co. v. Osborn, 35 Conn. 7.

² Natusch v. Irving, Gow on Partnership, 576; *Re* Phoenix Life Assur. Soc., 2 J. & H. 441.

³ Ashton v. Burbank, 2 Dill. 435.

⁴ Ashbury Ry. Carriage, &c. Co. v. Riche, L. R. 7 H. L. 653.

⁵ Southern Penn. R. R. Co. v. Stevens, 87 Pa. St. 190.

⁶ Chambers v. Falkner, 65 Ala. 448, 454; Grand Lodge v. Waddill, 36 Ala. 313. Compare Waddill v. Alabama, &c. R. R. Co., 35 Ala. 323.

⁷ Downing v. Mt. Washington Road Co., 40 N. H. 230; Wiswall v. Greenville, &c. Plank Road Co., 3 Jones, Eq. 183.

⁸ Rensselaer, &c. R. R. Co. v. Davis, 43 N. Y. 137; Waldo v. Chicago, &c. R. R. Co., 14 Wis. 575; Pacific R. R. Co. v. Seely, 45 Mo. 212; Morgan v. Donovan, 58 Ala. 241; Mayor of Norwich v. Norfolk Ry. Co., 4 El. & Bl. 397; Eastern Counties Ry. Co. v. Hawkes, 5 H. L. C. 331.

⁹ Atty.-Gen. v. Great Northern Ry. Co., 1 Dr. & Sm. 154; s. c. 6 Jur. N. s. 1006.

steamboat or navigation company,¹ or carry on a brewery or the like.²

A railroad, or other transportation company, chartered to transact business upon a certain line of road only, has no implied authority to extend its business over other roads.³ But this refers merely to the main business of the company, and does not imply that a railway company may not enter into traffic arrangements with other companies, for the conveyance of passengers and freight to distant points.⁴

It has been held that a railroad company has no right to guarantee the expenses of a great musical festival, in anticipation of great profits to be earned by the increase of traffic caused thereby.⁵

§ 395. **Alteration of Charter not impliedly authorized.**—The charter of a private corporation cannot be altered without the consent of the legislature,⁶ nor without the consent of every member of the corporation.⁷ That such consent cannot be implied, seems self-evident. A grant, by the legislature, of permission to act in a corporate capacity for a specified purpose, does not *impliedly* authorize the grantees to assume corporate powers for any other purpose. Nor do the members of a corporation, when they unite to do business under a particular charter, *impliedly* agree to become parties to a different charter. A contract never *impliedly* gives an option to either party to alter the terms originally agreed upon. No one would suppose that a majority, or any portion, of the members of a copartnership, have implied authority to adopt new or altered articles of association on behalf of the rest of the

¹ Plymouth R. R. Co. v. Colwell, 39 Pa. St. 337.

² Lyde v. Eastern Bengal Ry. Co., 36 Beav. 14. *Supra*, § 364; *infra*, § 403.

³ Great Western Ry. Co. v. Preston, &c. Ry. Co., 17 U. C. Q. B. 477, 487; Simpson v. Denison, 10 Hare, 51; Abbott v. Baltimore, &c. Packet Co., 1 Md. Ch. 542; Deaderick v. Wilson, 8 Baxter, 108.

⁴ *Supra*, § 376.

⁵ Davis v. Old Colony R. R. Co., 131 Mass. 258. Compare State Board of Agriculture v. Citizens', &c. Ry. Co., 47 Ind. 407. It was also held that an organ company could not guarantee the expenses of the festival as a means of advancing its business of selling organs. Davis v. Old Colony R. R. Co., *supra*.

⁶ *Infra*, § 648.

⁷ *Infra*, §§ 641, 645, 1047.

company. It follows, upon the same principle, that no majority of the shareholders in a corporation, nor any agent of a corporation, can have any implied authority to agree, on behalf of all the shareholders, to an alteration of their charter.¹

§ 396. **Consolidation with other Company not impliedly authorized.**—The reasons stated in the preceding section apply with full force to a consolidation of several corporations into one. This can never be effected without the unanimous consent of the members of each company; and such consent cannot be inferred as an implied condition of their charter or articles of association.² It is equally clear that a corporation cannot be subdivided into two smaller companies, except with the consent of every shareholder.³

§ 397. **Authority to apply to the Legislature for an Alteration cannot be implied.**—Authority to use the property or funds of a corporation for the purpose of obtaining an alteration of the company's charter, by act of the legislature, can never be implied;⁴ nor can the corporate funds be used in order to procure the destruction of the company's charter by judicial proceedings.⁵ It is likewise wholly unauthorized on

¹ *New Orleans, &c. R. R. Co. v. Harris*, 27 Miss. 517, 537–539; *Stevens v. Rutland, &c. R. R. Co.*, 29 Vt. 545; *Lauman v. Lebanon Valley R. R. Co.*, 30 Pa. St. 46; *Southern Penn. Iron, &c. Co. v. Stevens*, 87 Pa. St. 190; *Ashton v. Burbank*, 2 Dill. 435; *Zabriskie v. Hackensack, &c. R. R. Co.*, 18 N. J. Eq. 178; *Kean v. Johnson*, 9 N. J. Eq. 407; *Black v. Delaware, &c. Canal Co.*, 24 N. J. Eq. 466; *Hartford, &c. R. R. Co. v. Croswell*, 5 Hill, 386; *Clearwater v. Meredith*, 1 Wall. 40. *Infra*, § 645. See *Railway Co. v. Allerton*, 18 Wall. 233, 235.

² *Mowrey v. Indianapolis, &c. R. R. Co.*, 4 Biss. 83; *Clearwater v. Meredith*, 1 Wall. 25; *Pearce v. Madison, &c. R. R. Co.*, 21 How. 441; *Tuttle v. Michigan Air Line R. R. Co.*, 35 Mich. 247; *New Or-*

leans, &c. R. R. Co. v. Harris, 27 Miss. 517; *McCray v. Junction R. R. Co.*, 9 Ind. 359; *Booe v. Same*, 10 Ind. 93; *Shelbyville, &c. Turnpike Co. v. Barnes*, 42 Ind. 498; *Clinch v. Financial Co.*, L. R. 4 Ch. 117; *Dougan's Case*, L. R. 8 Ch. 540. See also *infra*, § 646.

³ *Indiana, &c. Turnpike Co. v. Phillips*, 2 Pen. & W. 184; *Fulton County v. Mississippi, &c. R. R. Co.*, 21 Ill. 338.

⁴ See *supra*, § 295. If the directors of a corporation have express authority to apply to Parliament for an alteration, they may defray the costs out of the company's funds. *Lyde v. Eastern Bengal Ry. Co.*, 36 Beav. 10.

⁵ *Daniel v. Mayor of Memphis*, 11 Humph. 582.

the part of any person or persons to apply to the legislature, in the name and on behalf of a corporation, for an alteration of its charter, unless expressly authorized to do so by the whole body of shareholders.¹

§ 398. **Contracts in Anticipation of a Future Alteration are not impliedly authorized.** — A charter of incorporation does not impliedly confer authority to make a contract in anticipation of obtaining a new charter to supersede the existing one. Thus, a railway company has no implied authority to make an absolute contract to purchase lands for the purpose of building an extension, in anticipation of obtaining the requisite authority by act of Parliament.² Nor would the charter of a railway company impliedly confer authority to enter into a contract with regard to the traffic upon a line which the company may thereafter be chartered to build.³

A contract to sell out the concern of a company, and take, in payment, shares of a company about to be formed, is clearly unauthorized, unless expressly provided for by its charter.⁴

§ 399. **A Grant of New Franchises not an Alteration.** — The authorities cited in the preceding sections, and the reasons upon which they are founded, apply only to such alterations of the charter of a corporation as affect the agreement between the members of the company.

The charter of a corporation fulfils two distinct purposes: it provides the terms of the agreement of association between the shareholders of the company, and it also constitutes a grant of franchises, or privileges, from the State to the shareholders.

So far as the charter constitutes a contract between the shareholders, it cannot be altered by the legislature in any respect; nor can it be altered by any portion of the parties to that contract. A contract can be altered only with the unanimous consent of the contracting parties.

¹ See *supra*, § 296 *et seq.*

² *Gage v. Newmarket Ry. Co.*, 18 Q. B. 457; *Preston v. Liverpool, &c. Ry. Co.*, 5 H. L. C. 622.

³ *Midland Ry. Co. v. London, &c. Ry. Co.*, L. R. 2 Eq. 524.

Morris, &c. R. R. Co. v. Sussex R. R. Co., 20 N. J. Eq. 563; *Maunsell v. Midland, &c. Ry. Co.*, 1 H. & M. 130.

⁴ *Bird v. Bird's, &c. Sewage Co.*, L. R. 9 Ch. 358.

But the legislature may authorize a body of corporators to exercise new franchises without impairing those previously granted;¹ and if these new franchises can be exercised without a departure from the original contract between the corporators, there is no reason why they should not be accepted and exercised on behalf of the company, by the majority, or by the ordinary managing agents.² Thus, if the road of a turnpike or railroad company having authority to build a road of a certain general description is found impracticable after having been located, the majority may, with the consent of the legislature, locate a new road, falling within the general description contained in the charter.³ A law authorizing a river navigation company to increase the height of its dams would not alter the agreement of the shareholders of the company; it would merely enable the company to carry out its main purposes more fully and effectually, by removing a legal obstacle.⁴

§ 400. **A Discharge from Obligations to the State not an Alteration.**—Obligations imposed upon a corporation for the

¹ *Infra*, § 1083.

² In *Fry's Exr. v. Lexington, &c. R. R. Co.*, 2 Metc. (Ky.) 322, 323, Chief Justice Simpson said: "None of the stockholders are injured by the mere passage of the act of the legislature amending the charter. Unless the company shall adopt the amendment, and proceed to act under it, the subscribers have no just cause of complaint. . . . And if it should avail itself of such provisions in the amendment as are calculated to aid in the accomplishment of the original undertaking, and are entirely consistent therewith, it will have the right to do it. Every stockholder in a company which is organized for the purpose of constructing a railroad comes under an implied agreement that such amendments may be made to the charter as may be required to carry the original design into com-

plete effect. The corporation still has the power to execute the primary object of its creation, and if it should not attempt to use the means of the shareholders for any other purpose, they cannot claim to be absolved from their obligation to pay the amount of their subscriptions." See also *Everhart v. West Chester, &c. R. R. Co.*, 28 Pa. St. 339; *Gray v. Monongahela Nav. Co.*, 2 W. & S. 156; *Clark v. Monongahela Nav. Co.*, 10 Watts, 364; *Cross v. Peach Bottom Ry. Co.*, 90 Pa. St. 392; *Poughkeepsie, &c. Plank Road Co. v. Griffin*, 24 N. Y. 150; *Delaware, &c. R. R. Co. v. Irick*, 3 Zab. 321.

³ *Irvin v. Turnpike Co.*, 2 Pen. & W. 474. Compare *Fall River Iron Works Co. v. Old Colony, &c. R. R. Co.*, 5 Allen, 221; *Hamilton, &c. Plank Road Co. v. Rice*, 7 Barb. 157.

⁴ *Gray v. Monongahela Nav. Co.*, 2 W. & S. 156.

benefit of the public constitute no part of the agreement between the members of the company. The State may discharge obligations of this character without the consent of any of the shareholders of the company;¹ and, under these circumstances, the ordinary agents of the company are authorized to act within the scope of their powers, in the same manner as if such obligations had never existed. Thus, if a railroad or plank-road company is unable to mortgage its road solely by reason of the duties which it owes to the State, this disability may be removed by statute; and a mortgage executed by the directors thereafter will be valid.² Upon the same principle, it has been held that the legislature may pass an act enabling a bridge company to issue preferred stock; and that the majority may thereupon issue such stock in order to raise money for the necessary purposes of the corporation.³

A law discharging a railroad company from a requirement of its charter to make connection with another line of road is not unconstitutional; and, after the passage of such a law, no shareholder can complain if the majority decide not to

¹ *Infra*, § 1084.

² *Joy v. Jackson, &c. Plank Road Co.*, 11 Mich. 155. Compare *Lau- man v. Lebanon Valley R. R. Co.*, 30 Pa. St. 42, 45.

³ In *Covington v. Covington, &c. Bridge Co.*, 10 Bush, 76, 77, the court said: "The capital of the company having been expended, it was evident that, without the addition of some available means, the stock already taken must not only be sacrificed, but the enterprise itself prove a failure. It was necessary, therefore, to raise money, either by mortgaging the corporate property to secure its payment, or issuing preferred stock, in order to enable the company to complete the work. . . . The power of the legislature to enable the company to borrow money by mortgaging the whole of the corporate property to secure it must be

conceded. . . . The issuing of preferred stock, with the dividends to be first applied as provided in the amendments, is only a means of enabling the company to pledge the revenue of the corporation to obtain money, instead of pledging the franchise; the only distinction being that in the latter case the franchise itself, or the rights therein, may pass from the stockholder; while in the former, although the payment of the dividends may in effect lessen the value of the non-preferred stock, yet the last-named stockholders have left them a voice in the control and management of the corporation, with the right to share the profits when the dividends to the preferred stock have been paid." See also *Everhart v. West Chester, &c. R. R. Co.*, 28 Pa. St. 339, 353; but compare *infra*, §§ 463, 464.

make the connection as originally required, provided the company's enterprise be not thereby altered.¹ The same principle has been held applicable where the charter of a railroad company was amended by extending the time within which the company was required to complete the construction of its road.²

§ 401. **General Municipal Laws do not impair Charters.** — Corporations, as well as copartnerships, are by necessary implication subject to all such general municipal regulations as fall within the scope of the ordinary legislative powers of the State. Enactments of this character may enlarge or restrict the legal rights of a corporation, and alter the powers of its agents correspondingly; but they do not impair the contract between the members of the company, any more than they would impair the contract between the members of a copartnership under similar circumstances. Thus, the legislature may repeal a general law prohibiting the execution of notes payable to bearer, without impairing the charters of existing companies; and, after such repeal, the agents of a banking company, incorporated while the prohibition was in force, would be authorized to issue notes payable to bearer in the regular course of the banking business. The same principle would be applicable if only corporations or banking companies had been prohibited from issuing notes payable to bearer, and the prohibition had been repealed by a subsequent enactment.

Numerous cases illustrating this doctrine will be referred to in a subsequent chapter, in treating of the constitutionality of State legislation affecting private corporations.³

§ 402. **Authorities holding that the Power of Alteration may be implied.** — The views expressed in the preceding sections have not been universally adopted. There are authorities in favor of the doctrine that a majority of the shareholders in a corporation may, with the consent of the legislature, make

¹ *Wilson v. Wills Valley R. R. Co.*, 33 Ga. 470. *tural, &c. R. R. Co. v. Winchester*, 13 Allen, 29; *Clark v. Monongahela*

² *Taggart v. Western Md. R. R. Co.*, 24 Md. 564. See also *Agricul-* *Nav. Co.*, 10 Watts, 364. ³ *Infra*, Chapter XV.

fundamental changes in the purposes of the company as originally agreed upon in their charter or articles of association.¹ Thus, it has been held that a majority of the shareholders in a railroad company may build an extension to their line of road,² or materially alter the course of the road as fixed by the charter,³ or consolidate the company with another company,⁴ if the State grant them permission. These decisions, it will be perceived, are not in accordance with the weight of authority, nor can they be supported upon principle. It is probable, therefore, that they would not be followed, except in the States where they were rendered.

§ 403. *Alterations which are not Fundamental.* — It has sometimes been held that slight alterations may be accepted by vote of the majority, but that radical or fundamental changes can be effected only by unanimous consent; and there are many dicta in the authorities, to the effect that alterations which are auxiliary to the main design of a corporation, and not fundamental in their nature, may be accepted by the directors of the company, or a majority of the shareholders.⁵ But the principle is the same, whether the alteration be great

¹ See *Pacific R. R. Co. v. Hughes*, 22 Mo. 297; *Delaware R. R. Co. v. Tharp*, 1 Houst. 174; *Martin v. Pensacola, &c. R. R. Co.*, 8 Fla. 381; *Pacific R. R. Co. v. Renshaw*, 18 Mo. 210; *Commonwealth v. Cullen*, 13 Pa. St. 141. See *Dayton, &c. R. R. Co. v. Hatch*, 1 Disney, 84; *Marlborough Manuf. Co. v. Smith*, 2 Conn. 583.

² *Greenville, &c. R. R. Co. v. Coleman*, 5 Rich. Law, 118.

³ *Banet v. Alton, &c. R. R. Co.*, 13 Ill. 504; *Peoria, &c. R. R. Co. v. Elting*, 17 Ill. 429; *Illinois River R. R. Co. v. Zimmer*, 20 Ill. 654; *Ross v. Chicago, &c. R. R. Co.*, 77 Ill. 134; *Rice v. Rock Island, &c. R. R. Co.*, 21 Ill. 93.

Contra, *Witter v. Mississippi, &c. R. R. Co.*, 20 Ark. 488; *Hester v. Memphis, &c. R. R. Co.*, 32 Miss.

380, 381; *Champion v. Memphis, &c. R. R. Co.*, 35 Miss. 692; *Winter v. Muscogee R. R. Co.*, 11 Ga. 450; *Middlesex Turnpike Co. v. Locke*, 8 Mass. 268; *Stevens v. Rutland, &c. R. R. Co.*, 29 Vt. 545; *Hartford, &c. R. R. Co. v. Croswell*, 5 Hill, 386; *Marietta, &c. R. R. Co. v. Elliott*, 10 Ohio St. 57; *Manheim, &c. Turnpike Co. v. Arndt*, 31 Pa. St. 317. See also cases *supra*, §§ 119, 395. Compare *Simpson v. Denison*, 10 Hare, 54-56.

⁴ *Sprague v. Illinois River R. R. Co.*, 19 Ill. 174. Compare *Illinois, &c. R. R. Co. v. Cook*, 29 Ill. 243. *Contra*, see cases *supra*, § 396.

⁵ *Woodfork v. Union Bank*, 3 Cold. 488; *Pacific R. R. Co. v. Hughes*, 22 Mo. 297; *Pacific R. R. Co. v. Renshaw*, 18 Mo. 210; *Mower v. Staples*, 32 Minn. 284.

or small. It would never be contended that a majority of the members of a copartnership have implied authority to alter the partnership articles, in matters either small or great, without the consent of the other partners; and there is no reason for applying a different rule to the contract of association between shareholders in a corporation.

In *Zabriskie v. Hackensack, &c. R. R. Co.*,¹ Chancellor Zabriskie severely criticised several Illinois and Missouri cases, in which it was held that a majority of the stockholders might, by authority of the legislature, make a change, provided it be not a great or radical one. The Chancellor said: "The principle on which they are decided is wrong; and if it is once conceded that a majority of the corporators may, by authority of the legislature, change the object of the enterprise in small things, there is no principle of law by which they can be restrained in any a little larger, or in the character of the whole work. The same principle will lead the courts of Illinois and Missouri, as it did those in New York,² to allow radical changes, and must, if consistently applied, allow a charter for a railroad to be used for banking or insurance business, or for a canal, theatre, brewery, or beer saloon."

It should be observed, however, that the fact that an act of the legislature purports to involve an alteration or amendment of the charter of a corporation, does not always prove that it would, in fact, have this effect. Moreover, changes in the management of a corporation may, in many instances, be effected by the majority, pursuant to legislative authority, without impairing any provision of the original agreement by which the company was formed.

§ 404. **A Reservation of Power to alter or repeal a Charter does not increase the Powers of the Majority.** — Charters of incorporation are frequently granted subject to a reservation of

¹ *Zabriskie v. Hackensack, &c. R. R. Co.*, 18 N. J. Eq. 178, 191, 192. reserved power of alteration and repeal. See *infra*, §§ 1093, 1099. The correct rule prevails in New

² The Chancellor probably referred to the New York cases in which it was held that radical changes might be effected by exercise of the power of alteration and repeal is not reserved. *Hartford, &c. R. R. Co. v. Crosswell*, 5 Hill, 386.

power in the legislature "to repeal, alter, or suspend" them at pleasure. The object of a provision of this kind is to avoid the application of the rule laid down in the Dartmouth College case, that a charter of incorporation contains a contract which cannot be impaired by law without the consent of the contracting parties.

A charter granted subject to a reservation of power to repeal, alter, or suspend it, may be repealed or modified by the legislature at any time, and without the consent of the corporators.¹ But it has been a debated question whether a mere offer, by the legislature, of an altered charter, to a corporation whose original charter was granted to it subject to the reserved power of alteration or repeal, can be accepted by vote of a majority of the corporators, against the wishes of the minority.

It seems perfectly clear, that, when the members of a corporation accept a charter containing a reservation of power *in the legislature* to repeal or alter it at pleasure, they do not intend thereby to confer the power of alteration or repeal upon the majority, or any other agent of the company.

In *Zabriskie v. Hackensack, &c. R. R. Co.*,² the Chancellor said: "The charter of the defendants contains this provision, 'that the legislature may, at any time, alter, modify, or repeal the same.' The object and purpose of these provisions are so plain, and so plainly expressed in the words, that it seems strange that any doubt could be raised concerning it. It was a reservation to the State, for the benefit of the public, to be exercised by the State only. The State was making what had been decided to be a contract, and it reserved the power of change, by altering, modifying, or repealing the contract. Neither the words, nor the circumstances, nor the apparent objects for which this provision was made, can, by any fair construction, extend it to giving a power to one part of the corporators as against the other, which they did not have before. It was to avoid the rule in the Dartmouth College

¹ *Infra*, § 1073.

also *Kenosha, &c. R. R. Co. v.*

² *Zabriskie v. Hackensack, &c. Marsh*, 17 Wis. 16; *Cross v. Peach R. R. Co.*, 18 N. J. Eq. 185. See *Bottom Ry. Co.*, 90 Pa. St. 395.

case, not that in *Natusch v. Irving*,¹ that the change was made. The words limit the power to that object."

§ 405. **The Effect of an Offer of an Amendment where the Power of Amendment was reserved.** — It is well settled, however, that the legislature may, by virtue of a reservation of this character, repeal or alter a charter, against the will of every member of the corporation. And an alteration may, under these circumstances, be made conditional, so that it shall go into effect if it be accepted by a majority of shareholders, but not otherwise. In this case the power of the majority to accept the alteration on behalf of the company is derived from the arbitrary will of the legislature, and not from the unanimous agreement of the corporators.

It has been held in numerous cases, that, where the legislature has the power to make an alteration compulsory, but in terms makes it conditional upon its acceptance by the corporation, this impliedly means that the alteration shall go into effect provided it be accepted by vote of the majority. According to this view, a law purporting to *authorize* a corporation to extend its business means that *it shall* extend the business if the majority of the corporation so desire.²

It does not appear clearly, that the course of reasoning indicated in the text was followed in any of the cases referred to. But it is the only course of reasoning apparent to the writer by which these decisions can be reconciled to well-

¹ See *infra*, § 643.

² *Durfee v. Old Colony, &c. R. R. Co.*, 5 Allen, 230; *Northern R. R. Co. v. Miller*, 10 Barb. 260; *White v. Syracuse, &c. R. R. Co.*, 14 Barb. 560; *Schenectady, &c. Plank Road Co. v. Thatcher*, 11 N. Y. 102; *Buffalo, &c. R. R. Co. v. Dudley*, 14 N. Y. 336; *Sprigg v. Western Tel. Co.*, 46 Md. 67; *Pacific R. R. Co. v. Renshaw*, 18 Mo. 213; *Meadow Dam Co. v. Grey*, 30 Me. 551; *Mowrey v. Indianapolis, &c. R. R. Co.*, 4 Biss. 78. Compare *Joslyn v. Pacific Mail S. S. Co.*, 12 Abb. Pr. n. s. 329;

Midland, &c. Ry. Co. v. Gordon, 16 M. & W. 803; and see *infra*, § 407.

In *Zabriskie v. Hackensack, &c. R. R. Co.*, *supra*, § 403, most of the above decisions were ably criticised by the Chancellor, upon the supposition that they were based upon the doctrine of an implied delegation of authority by the corporators to a majority of their number. But the view that the power of the majority was derived from the act of the legislature in the exercise of its compulsory powers was not adverted to.

established principles. It is true, that an offer to "a corporation" literally means an offer to the whole corporation, and not to a majority merely. But the distinction between the majority and the corporation itself is frequently overlooked in practice, because the majority usually represent the corporation in all things which the corporation itself can do. It is, perhaps, not too great a stretch of construction to hold that the legislature *intended* that the alteration should be accepted by vote of the majority, (this being the usual method by which corporations express their assent,) although it was in terms offered to "the corporation."

§ 406. **A Reservation of Power to alter a Charter does not include the Power to change it.** — A reservation, by the legislature, of power *to alter* a charter, does not include the power of making radical changes.¹ And where the legislature has no power to change a charter peremptorily, it cannot enable the majority to do so against the will of a minority. Any *change*, which is not a mere alteration, cannot be made without the unanimous consent of the shareholders, even though the power to *repeal* or *alter* the charter at pleasure be reserved by the legislature.²

§ 407. **Changes in the Constitution of a Corporation may be made by the Majority, if provided for in the Charter.** — It is evidently the intention of all the parties who join in creating a corporation, that all acts which are done by the company under its charter shall be done in the usual manner, and by the agencies through which a corporation usually acts. The majority in shareholders' meeting, and in some instances the board of directors,³ are impliedly invested with full powers to do on behalf of the corporation whatever they deem judicious in carrying out the company's chartered purposes. If

¹ *Infra*, § 1096.

² *Zabriskie v. Hackensack, &c. R. R. Co.*, 18 N. J. Eq. 192; *White v. Syracuse, &c. R. R. Co.*, 14 Barb. 560; *Buffalo, &c. R. R. Co. v. Dudley*, 14 N. Y. 348; *Durfee v. Old Colony, &c. R. R. Co.*, 5 Allen, 247,

248; *Bank v. City of Charlotte*, 85 N. C. 433; *Hoey v. Henderson*, 32 La. Ann. 1069.

³ As to the extent of the powers of the majority and board of directors, see *infra*, Chapter VII.

the charter contains a provision purporting to authorize *the corporation* to do a certain act, this is not merely a grant of authority from the legislature to the corporation, but it enters into the agreement of the shareholders, and impliedly invests the majority, or the board of directors, with authority to do the act on behalf of the corporation. This is true although a change in the company's constitution, or an alteration of the character of its main enterprise, be the result. The powers of the majority, or board of directors, under these circumstances, are derived strictly from the agreement of the shareholders.¹

It has been held accordingly, that, if the charter of a corporation authorizes the capital stock of the company "to be increased from time to time, at the pleasure of *the said corporation*," this impliedly includes a delegation of power to the majority, in shareholders' meeting, to declare the pleasure of the corporation.² So, if two corporations are authorized by their charters, or by a general law, which must be considered as part of their charters, to form a single company by consolidation, a consolidation may be effected by a majority of the shareholders of the several companies at general meetings duly convened.³

If the general law under which a railroad company was organized authorizes any company formed under the act to

¹ Under an express delegation of authority, the majority or any agent of a corporation may apply to the legislature for an alteration, and accept an offered alteration, on behalf of the whole company. *Lyde v. Eastern Bengal Ry. Co.*, 36 Beav. 10.

² *Railway Co. v. Allerton*, 18 Wall. 236.

³ In *Nugent v. Supervisors*, 19 Wall. 241, Justice Strong said: "In a multitude of cases decided in England and in this country, it has been determined that a subscriber for the stock of a company is not released from his engagement to take it and pay for it by any alteration of the

organization or purposes of the company, which, at the time the subscription was made, were authorized either by the general law or special charter; and a clear distinction is recognized between the effect of such alterations and the effect of those made under legislation subsequent to the contract of subscription."

See *Sparrow v. Evansville, &c. R. R. Co.*, 7 Ind. 369; *Bish v. Johnson*, 21 Ind. 299; *Cork, &c. Ry. Co. v. Paterson*, 37 Eng. L. & Eq. 398; *Nixon v. Brownlow*, 3 H. & N. 686; *Lynch v. Eastern, &c. Ry. Co.*, 57 Wis. 431.

extend its tracks beyond the limit fixed in the certificate of incorporation, an extension, made with the consent of a majority of the shareholders, would be authorized, though there were dissenting members.¹

§ 408. **When a Corporation may begin to carry on Business.** — **Capital must be subscribed.** — The subscription of the entire capital stock fixed by the charter of a corporation is not, as a rule, a condition precedent to the formation of a corporate association between those who subscribe for shares. But in the absence of some provision indicating a contrary intention, the subscription of the entire capital fixed by the charter is always a condition precedent to the right of the company to begin the prosecution of its main enterprise. The object of fixing the capital of a corporation at a definite sum is to indicate the scope of the company's business, and the amount of capital deemed necessary for the transaction of the business contemplated. It indicates to shareholders their fractional interests in the whole concern, and the extent of the enterprise in which they are invited to join. Until the amount of capital fixed by the charter has been subscribed, the right of the company to begin to carry on business remains inchoate, and the agents of the company have no authority to perform any acts except such as are necessary to perfect its organization, and prepare it for the prosecution of its regular business after the capital agreed upon has been obtained.² It has for this reason been held, in numerous cases, that the subscribers for shares cannot be compelled to contribute the capital subscribed by them for the purpose of carrying on the company's business, until the amount of capital indicated by the charter has been subscribed.³

§ 409. **Preparatory Arrangements.** — Although the capital of a corporation is fixed by its charter at a certain sum, the company has a right to perfect its organization, and to do all acts which are required to prepare it for entering upon its regular business, before the whole capital has been subscribed.

¹ *Sims v. Street R. R. Co.*, 37 Ohio St. 556. *Allman v. Havana, &c. R. R. Co.*, 88 Ill. 521.

² *Bray v. Farwell*, 81 N. Y. 607; ³ See *supra*, § 137.

The officers of the company are impliedly authorized to open offices, issue prospectuses, solicit and receive subscriptions for shares, and prepare plans for the execution of the company's main enterprise.¹

In *Salem Mill Dam Co. v. Ropes*,² the charter of a company formed for the purpose of erecting mill dams authorized the company to organize and "arrange its affairs" as soon as one fifth of the whole capital had been subscribed. This provision was construed to give the power to make a careful examination into the probable success of the project and the expense of carrying it into execution, to cause plans and surveys to be made, to employ the necessary agents, to hold meetings, to obtain legal advice, and in general to do whatever was necessary to determine the advisability of proceeding with the main enterprise and to procure further subscriptions. The court held that the power of levying assessments upon the shareholders, in order to provide the means of accomplishing these purposes and to defray the expenses incurred in obtaining the act of incorporation, followed as a necessary consequence.

§ 410. **Express Provisions authorizing Business to be begun upon Subscription of Part of the Company's Capital.** — If the charter of a corporation provides that it may begin the prosecution of its enterprise, in whole or in part, upon the subscription of a specified amount of its capital, it is clear that the agents of the company may begin to carry on its business, and may make the required calls upon its shareholders, as soon as the specified amount of capital has been subscribed. Whether a corporation is authorized to begin its business before the whole amount of its capital has been subscribed, can only be determined upon a construction of the entire charter under which the company was formed.³

It has been held in a number of cases, that a provision in

¹ *Central Turnpike Co. v. Valentine*, 10 Pick. 142.

² *Salem Mill Dam Co. v. Ropes*, 6 Pick. 23, 43.

³ *Boston, &c. R. R. Co. v. Wel-*

lington, 113 Mass. 79. See *Boston, &c. R. R. Co. v. Pearson*, 128 Mass. 445; and compare *Bray v. Farwell*, 81 N. Y. 600.

the charter or law under which a corporation was formed, authorizing the company to organize and elect officers as soon as a specified per cent of its capital has been subscribed, by implication authorizes the company to begin the prosecution of its main business at the same time.¹ The reasoning by which this conclusion was reached, in the cases referred to, appears to the writer to be unsatisfactory.²

§ 411. **Duration of Corporations.** — A corporation whose charter does not limit its existence to a definite period of time continues in existence, in legal contemplation, until it has been declared dissolved by one of the methods prescribed by law.³ The existence of the corporation, in legal contemplation, does not necessarily indicate that the corporation has any right to carry on business, or that it is in existence as a matter of fact. The fiction of a corporate existence is preserved even after the company has entirely ceased to do business and wound up its affairs, and after the contract between the shareholders has been dissolved by unanimous consent.⁴

The grant of a charter of incorporation, where there is no provision to the contrary, confers upon the grantees the right of acting in a corporate capacity in carrying out the purposes set forth in the charter, during an unlimited period of time. It is also an implied condition in the contract between the shareholders in a corporation, that the company shall continue in existence, and shall prosecute the business for which

¹ *Schenectady, &c. Plank Road Co. v. Thatcher*, 11 N. Y. 102, 107; *Hunt v. Kansas, &c. Bridge Co.*, 11 Kans. 412; *Willamette Freighting Co. v. Stannus*, 4 Oreg. 261; *Massey v. Building Ass.*, 22 Kans. 624.

² A provision authorizing the directors to make calls upon the subscribers at such times as they may see fit, would not indicate that the main business of the company may be begun before its capital has been subscribed, or that the subscribers agree to pay before the whole company has been formed by

subscription of all of its shares. See *supra*, §§ 143, 149.

³ *Infra*, § 1002 *et seq.*

A charter providing that the corporators shall have "perpetual succession" incorporates them for an unlimited period of time, although there be a general law enacting that the duration of a corporation, when not limited by the charter to a particular time, shall be twenty years. *Fairchild v. Masonic Hall Ass.*, 71 Mo. 526, overruling *Scanlan v. Crawshaw*, 5 Mo. App. 337.

⁴ *Infra*, § 1002.

it was formed, at least so long as the majority deem this advisable and the main object of the company has not become impossible of attainment. The individual shareholders clearly have no power to dissolve the corporation by surrendering its franchises to the State; nor can they interfere with the management of the company,¹ or insist on having its affairs wound up, against the wishes of the majority.² A corporation differs in this respect from a simple copartnership, which exists merely at the will of its members, and may be dissolved by any one of them at any time, if no certain period for its duration was agreed upon in the partnership contract.³

§ 412. **When it is the Duty of a Corporation to wind up its Business.** — The general rule stated in the preceding section must be taken subject to the qualification, that, if it turns out that the purposes for which a corporation was formed cannot possibly be attained, it is the duty of the company to cease transacting business, and to wind up its affairs; for any transaction in which the company might engage, under these circumstances, would necessarily involve a departure from the purposes for which the company was incorporated.

The ultimate object of every ordinary trading corporation is evidently the pecuniary gain of its shareholders. It is for this purpose alone that ordinary trading corporations are chartered, and for this purpose and no other have the shareholders advanced their shares of the capital. It seems to follow, therefore, that after a corporation of this character has become hopelessly insolvent, or unable to carry on its business except at a loss, it is the duty of the managers of the company to stop carrying on its business any further, and to wind up its affairs. To continue the business of the company under these circumstances would involve both an unauthorized exercise of corporate franchises,⁴ and a breach of the contract between the shareholders.⁵ For the same reason, it follows that, if circumstances have rendered it impossible to continue to

¹ *Supra*, §§ 282-285.

⁴ *Infra*, § 1026.

² *Pratt v. Jewett*, 9 Gray, 34.

⁵ *Supra*, § 284.

³ 1 *Lindley on Partnership* (4th Lond. ed.), 232-235.

carry on the particular kind of business for which a corporation was formed with profit to the shareholders, it is the duty of the managing agents to wind up the company's affairs voluntarily.

It is well settled that a copartnership may be dissolved, under similar circumstances, by any one of its members, although the partnership agreement provides that the company shall continue for a definite term of years.¹ And the rule applicable in case of a copartnership has been held to be fully applicable in case of a corporation or joint-stock company.² The reasonableness of this doctrine requires no com-

¹ Thus, in *Baring v. Dix*, 1 Cox, 213, the question arose whether a partnership, which had been formed for the purpose of spinning cotton under a certain patent, should be dissolved, after the invention had turned out to be a failure, and had been given up entirely. Lord Kenyon referred the case to the master, "to inquire and state to the court whether the said copartnership business could now be carried on, according to the true intent and meaning of the said articles of copartnership," and declared that, if the master should report that the business could not be so carried on, he would dissolve and wind up the company.

In *Bailey v. Ford*, 13 Sim. 495, Vice-Chancellor Shadwell ordered that a partnership entered into for a term of twenty-one years should be wound up before the expiration of the term, because it had become wholly insolvent, and its affairs were daily growing worse.

In *Jennings v. Baddeley*, 3 K. & J. 78, Vice-Chancellor Page-Wood held that a partnership which had been entered into for a term of years should be dissolved before the end of the term, after it had turned out that the business could not be carried on profitably without further

capital, each partner having contributed his share according to the partnership agreement, and some of the partners being unwilling to contribute any more; and that it was immaterial whether the concern be already embarrassed or not. The Vice-Chancellor said: "The doctrine of this court has always been, that expectation of profit is implied in every copartnership; that every partnership is entered into by the partners with the view of deriving profit from the concern. No one can suppose that persons who have agreed to carry on business for a certain term will continue to carry it on during as many years as the term may have to run, when it is clear that during the residue of the term they must be working at a certain loss." See also *Brien v. Hariman*, 1 Tenn. Ch. 467; *Holladay v. Elliott*, 8 Oreg. 84; *Sieghortner v. Weissenborn*, 20 N. J. Eq. 172; *Howell v. Harvey*, 5 Ark. 270; *Van Ness v. Fisher*, 5 Lans. 236.

² *Re Suburban Hotel Co.*, L. R. 2 Ch. 737, 743-750, *per* Lord Cairns. See also *Re Factage Parisien*, 13 W. R. 214; *Id.* 330; *Bank of Switzerland v. Bank of Turkey*, 5 L. T. N. s. 549; *Marr v. Union Bank*, 4 Cold. 484; *De Witt v. Hastings*,

ment; it is a protection to creditors and to the public when applied to companies whose shareholders are not individually liable for the corporate obligations, and it is in all cases a protection to the individual shareholders against unfair dealing on the part of the managers of their company, or the majority.

§ 413. **The Discretionary Power of a Majority to wind up the Company's Business.**— Ordinary trading corporations are formed solely for the pecuniary benefit of their shareholders. It is therefore no more than reasonable that the majority of an association of this description should have a discretionary power to give up the joint speculation, and wind up the company's business, whenever they deem this step to be in the interest of the whole association.

The law is settled accordingly; and it may be stated as a rule, that it is an implied condition in the charter of every corporation formed solely for the pecuniary profit of its shareholders, such as an ordinary trading or manufacturing corporation, that its business may be wound up whenever the majority deem this to be expedient. Under these circumstances the majority may, without the consent of the minority, sell the whole of the company's property, close up the business, distribute the assets, and surrender the charter to the State.¹

But the majority of a corporation have no right to sell property which is necessary to enable the company to carry on its business under the charter, unless this be done in good faith, for the purpose of distributing the proceeds after pay-

69 N. Y. 518; *Lafond v. Deems*, 52 How. Pr. 41; 81 N. Y. 507; and see *supra*, §§ 284, 285.

¹ *Treadwell v. Salisbury Manuf. Co.*, 7 Gray, 393. See also *Buford v. Keokuk, &c. Packet Co.*, 3 Mo. App. 159, 169; *Merchants', &c. Line v. Waganer*, 71 Ala. 581; *Wilson v. Central Bridge Co.*, 9 R. I. 590; *Black v. Delaware, &c. Canal Co.*, 22 N. J. Eq. 404, 415, 416; *Lau-*
man v. Lebanon Valley R. R. Co.,

30 Pa. St. 42; *Wilson v. Miers*, 10 C. B. N. s. 348; *Bank of Switzerland v. Bank of Turkey*, 5 L. T. N. s. 549. Compare *Kean v. Johnson*, 9 N. J. Eq. 413; *Curien v. Santini*, 16 La. Ann. 27; *Polar Star Lodge v. Polar Star Lodge*, 16 La. Ann. 53; *Mobile, &c. R. R. Co. v. State*, 29 Ala. 586, 587; *Abbot v. American Hard Rubber Co.*, 33 Barb. 579.

ing off creditors, and finally winding up the company's affairs. The majority would have no implied authority to sell out the company's property as a speculation, with the intention of starting the company's business anew at a subsequent time.

§ 414. **To what Corporations the Rule does not apply.**—The right of a majority of shareholders to wind up the company's business, and distribute its assets, exists only provided the company was formed solely for the benefit of its shareholders. The majority of a charitable corporation, or any corporation formed to administer a trust in favor of third persons, evidently possess no such power. Nor can such a power be exercised by the majority of a corporation which has obtained its property through exercise of the right of eminent domain in the State, and has assumed obligations to the public. Even the unanimous consent of the shareholders of a railroad company would not discharge the company from the duty of providing the public with means of transportation, or enable the shareholders to appropriate for their sole benefit the property which was obtained for a public use under the power of eminent domain.¹

§ 415. **After winding up, Capital must be distributed in Cash.**—Upon winding up the business of a corporation, the proceeds of a sale of its assets, after paying off creditors, must be distributed among the shareholders in cash. It is a fundamental principle, that property or funds belonging to a corporation cannot be applied in any manner inconsistent with the chartered purposes of the company, without the unanimous consent of its shareholders. Thus a sale of the property of a corporation to another company, in consideration of a transfer of shares in the latter company to the shareholders of the former, is clearly not impliedly authorized. No majority have any implied authority to constitute any dissenting shareholder a member of another corporation.

¹ *Infra*, §§ 1114, 1116. If, however, the legislature should discharge a railroad company from its obligations to the public, the majority would have the same powers as in case of other classes of corporations.

A transaction of this description would in effect amount to a consolidation of the two companies.¹

But a corporation may sell out its assets, and receive in payment stock in another company, having a fixed money value and convertible into cash at any time. The stock received under these circumstances is taken in lieu of money. It may be distributed *in specie* among those shareholders who are willing to accept it, but should be converted into cash and the proceeds distributed among those who do not consent to the arrangement.²

§ 416. The shareholders in a corporation are entitled to an immediate distribution of the company's capital after its business has been brought to a close and settled up.³ They cannot be compelled to accept an annuity in place of their shares. Hence a transfer of the assets of a corporation by a sale, or a long lease in consideration of an annual rent, is unauthorized, although made in good faith for the purpose of closing out the company's business, unless provision be made for paying to dissenting shareholders, the value of their shares in the whole property in cash.⁴

§ 417. **Arrangements for winding up Corporations.**—In winding up the business of a corporation, the majority should use their discretion to obtain the most favorable terms for the benefit of all the shareholders. It seems reasonable, therefore, that the majority should be entitled to make a lease of the whole property, or apply it to any other use which they may find profitable, provided this be done in good

¹ *Re Empire Ass. Co.*, L. R. 4 Eq. 341; *Clinch v. Financial Co.*, L. R. 4 Ch. 117; *McCurdy v. Myers*, 44 Pa. St. 535; *Bird v. Bird's, &c. Sewage Co.*, L. R. 9 Ch. 358; *Frothingham v. Barney*, 6 Hun, 366. *R. R. Co. v. Boston, &c. R. R. Co.*, 115 Mass. 351; *Winch v. Birkenhead, &c. Ry. Co.*, 5 De G. & Sm. 562; *Conro v. Port Henry Iron Co.*, 12 Barb. 27, 63.

² *Treadwell v. Salisbury Manuf. Co.*, 7 Gray, 393, 397, 405. Compare *Featherstonhaugh v. Lee Moor, &c. Clay Co.*, L. R. 1 Eq. 318, stated *supra*, § 367; *Midland Ry. Co. v. Great Western Ry. Co.*, L. R. 8 Ch. 841, stated *supra*, § 379; *Gratz v. Pennsylvania R. R. Co.*, 41 Pa. St. 447.

³ *Frothingham v. Barney*, 6 Hun, 366; *Taylor v. Earle*, 8 Hun, 1; *McVicker v. Ross*, 55 Barb. 247.

⁴ *Black v. Delaware, &c. Canal Co.*, 24 N. J. Eq. 455; *Middlesex*

faith, for the purpose of finally winding up the business of the corporation, and provided every shareholder who is unwilling to join in the new enterprise be given the full value of his shares. A transaction of this description would be the same in effect as a purchase of the entire property for cash, and an immediate reinvestment, by those shareholders who consent to the arrangement, of their shares of the purchase-money. Chancellor Zabriskie said: "If I am right in the conclusion arrived at above, that the majority of corporators under a charter, which specifies no definite time for its continuance, have a right to abandon the undertaking and dispose of and divide the property, the proceeding in this case is valid, as against the complainants, as a lawful way of accomplishing that end as to them. Two thirds of these corporators have determined that they do not desire to go on with these enterprises under the charters, and that they wish to abandon them, and are willing to accept as their share of the corporate property a yearly rent or annuity secured by a provision like that contained in this proposed lease. Some stockholders are not willing; and although the majority can effect the abandonment, they cannot compel the dissentients to accept like compensation for their stock; it might be compelling them to embark their capital in a new enterprise. Provision is therefore made to pay or return to them the full value of their shares of the whole property of the corporation. This is all they would have if the works were sold out. The provision is a most equitable one, and without it the transaction, even if valid and legal, would not be equitable and just."¹

It is evident, however, that authority to enter into an arrangement of the kind above described can exist only under extraordinary circumstances. A majority of the shareholders in a corporation have no implied right or power to expel or drive out the minority, upon paying them the value of their shares; nor can the majority compel the minority to elect whether they will consent to a departure from the company's

¹ *Black v. Delaware, &c. Canal* 455; *Lauman v. Lebanon Valley Co.*, 22 N. J. Eq. 415; 24 N. J. Eq. R. R. Co., 30 Pa. St. 42.

original purposes, or withdraw with the value of their shares. The existence of such a power would be intolerable. The majority have a right to wind up the business of their company only provided they do this in good faith in the interest of all the shareholders, and because the further prosecution of the business for which the company was formed would be unprofitable. They have a right to dispose of the assets by lease or exchange, instead of selling them for cash, only if, under all the circumstances of the case, this is a reasonable method of obtaining the best price for the property. The right to exercise a power of this description involves the exercise of discretion, and, as in all other cases of discretionary powers, depends largely upon the good faith of the parties.

§ 418. **Charters in Force for a Limited Period of Time.** — It is often provided in charters and general incorporation laws, that the corporations formed under them shall continue in existence for a limited period of time only. Provisions of this character are usually inserted for the benefit of the State: their purpose is to limit the duration of the franchises granted by the State to the corporators, rather than to bind the latter to continue their business for any definite period of time. However, if the meaning of a provision in the charter of a corporation is that the company's business shall be carried on for a definite period of time, it is evident that no majority should have a right in their discretion to shorten that period, even with the consent of the State.¹ But if the provision is intended merely as a limitation upon the duration of the franchises granted to the corporators, there is no reason why the majority should not be held to have implied authority, as in other cases, to wind up the business of the company, whenever they deem this to be expedient. Even if the charter of a corporation expressly provides that its business should be carried on during a speci-

¹ See *per* Chancellor Zabriskie, in *Black v. Delaware, &c. Canal Co.*, 22 N. J. Eq. 403, 404-406, 415; *Von Schmidt v. Huntington*, 1 Cal. 55. As to the effect of such a limitation upon the powers of the corporation to make engagements, see *supra*, § 330.

fied period of time, this would be subject to an implied condition that the prosecution of the business in the manner contemplated by the charter should continue practicable. It is the right and the duty of every corporation to wind up its business whenever it can no longer be carried on with a chance of profit, or in accordance with the company's chartered purposes.¹

§ 419. **When a Corporation may abandon a Portion of its Enterprise and continue the Remainder.**— A corporation may, for reasons of expediency, abandon a portion of the enterprise for which it was incorporated, provided the result be merely to contract the business within smaller limits, and not to change its character.² Each case of this description must be considered with respect to the peculiar circumstances under which it arises, and the nature of the company's enterprise. If an abandonment of a portion of the enterprise of a corporation is a reasonable proceeding, under all the circumstances, in carrying out the speculation in which the shareholders have embarked, it is authorized. But if the abandonment of a portion of the enterprise for which a corporation was formed would substantially alter the character of the remainder, it would not be impliedly authorized by the charter. Thus, in some instances, a railroad company has no authority to abandon the construction of a portion of the line of road which it was chartered to construct.³ Under other circumstances, a different rule would apply.

§ 420. **When a Corporation may purchase the whole Concern of another Company.**— The question whether or not a corporation may purchase the whole concern of another company depends upon the circumstances of the case. A corporation

¹ *Supra*, § 412.

² *Re Norwegian, &c. Iron Co.*, 35 Beav. 223; *Moss v. Averell*, 10 N. Y. 449; *Commonwealth v. Fitchburg R. R. Co.*, 12 Gray, 180.

³ *People v. Albany, &c. R. R. Co.*, 24 N. Y. 261; *Cohen v. Wilkinson*, 12 Beav. 125; *Bagshaw v. Eastern Union Ry. Co.*, 2 MacN. &

G. 389. Compare *Commonwealth v. Fitchburg R. R. Co.*, 12 Gray, 180; *Platteville v. Galena, &c. R. R. Co.*, 43 Wis. 493. Compare *People v. Improvement Co.*, 103 Ill. 491.

As to the duty of a railroad company to operate its road for the benefit of the public after it has been constructed, see *infra*, § 1116.

may purchase from another company, as well as from an individual; and it may acquire any property which is needed for the attainment of a purpose authorized by its charter, upon the most advantageous terms which it can obtain. If, then, one company should desire to sell all of its fixtures and stock in trade, and another company should have a legitimate use for substantially the same property in carrying on its own business, the latter company would be entitled to purchase the whole concern of the former. Under these circumstances, it would not be an objection to the transaction, that a portion of the property was not required by the purchasing company in carrying on its proper business, if the bulk of the property was purchased in good faith for authorized purposes, and the remainder merely as a means of effecting an advantageous bargain.¹ And there is no reason why the purchasing company should not pay for the property so obtained, by assuming certain debts of the selling company instead of paying cash.²

§ 421. **A Corporation has no implied Authority to enter into a Partnership.** — It seems clear that corporations are not impliedly authorized to enter into partnership with other companies, or with individuals. The existence of a partnership not only would interfere with the management of the corporation by its regularly appointed officers, but would impair the authority of the shareholders themselves, and involve the company in new responsibilities through agents over whom it would have no control.³

¹ *Moss v. Averell*, 10 N. Y. 449.

² See *Ernest v. Nicholls*, 6 H. L. C. 400.

Another question may arise in case of the transfer of the whole of a business, like that of an insurance company, from one company to another. It has been held that the officers of an insurance company are appointed to take the risks in each separate case upon an examination of its merits; it may therefore be doubted whether they can be considered to have implied authority to

assume the risks taken by the agents of another company. *Re Era Assurance Co.*, 2 J. & H. 404; 1 De G., J. & S. 29; 1 H. & M. 678. Compare *Ernest v. Nicholls*, 6 H. L. C. 421.

³ *Whittenton Mills v. Upton*, 10 Gray, 582; *Marine Bank v. Ogden*, 29 Ill. 248; *New York, &c. Canal Co. v. Fulton Bank*, 7 Wend. 412; *Morris Run Coal Co. v. Barclay Coal Co.*, 68 Pa. St. 173; *Charlton v. New Castle, &c. Ry. Co.*, 5 Jur. N. S. 1097; *Burke v. Concord R. R. Co.*, 8 Am. & Eng. R. R. Cases, 552; *State v.*

§ 422. **Transfer of the whole Concern of a Corporation to another Company.**—The franchises of a corporation are merely personal privileges, and cannot, in the nature of things, be transferred like tangible property. A transfer of franchises in reality means a grant of new franchises by the State to the transferee. It is evident, therefore, that an attempted transfer of franchises without the consent of the State, such consent operating as a grant to the transferee, is simply void.¹

The validity of a transfer of all the property and rights of a corporation, not including its franchises, to another company, depends upon other principles.

It must then be considered, —

First. Whether the transfer is authorized by the charter of the transferring company.

Secondly. Whether the receiving company has authority by its charter to acquire the property.

Thirdly. Whether the courts are bound, for reasons of public policy or for the protection of the rights of the State, to treat the transfer as invalid.

§ 423. **The Corporate Funds cannot be given away gratuitously.**—The property and funds of a corporation belong to its shareholders, and cannot be devoted to any use which is not in accordance with their chartered purposes, except by unanimous consent. No agent of a corporation has implied authority to give away any portion of the corporate property, or to create a corporate obligation gratuitously.² It follows,

Concord R. R. Co., 13 Am. & Eng. R. R. Cases, 94. Compare Ontario Salt Co. v. Merchants' Salt Co., 18 Grant's Ch. (U. C.) 541; Allen v. Woonsocket Co., 11 R. I. 288.

A corporation may, however, hold property as tenant in common with another corporation or a natural person. Estell v. University, 12 Lea (Tenn.), 476.

¹ *Infra*, § 924.

² Atty.-Gen v. Mayor, &c. of Batley, 26 L. T. N. s. 392; *Ex parte* Mellish, 8 L. T. N. s. 47; Jones v.

Morrison, 31 Minn. 140; Bissell v. City of Kankakee, 64 Ill. 249; Brodhead v. City of Milwaukee, 19 Wis. 658; Polar Star Lodge v. Polar Star Lodge, 16 La. Ann. 53; Frankfort Bank v. Johnson, 24 Me. 490; Salem Bank v. Gloucester Bank, 17 Mass. 30; St. James's Church v. Church of Redeemer, 45 Barb. 356. Nor can they condone a fraudulent misapplication of the corporate funds. Minor v. Mechanics' Bank, 1 Pet. 71. *Infra*, § 622.

for the same reason, that authority can never be implied to lend the credit of a corporation without a consideration, or to sign its name to negotiable paper for the accommodation of others.¹ Thus, a railroad company is not liable upon a guaranty of the bonds of a connecting road, made by its agents without a consideration, and induced merely by the expectation of an increase of business.² But a guaranty or indorsement of the bonds of another company, made for a valuable consideration and for a legitimate purpose, may be in furtherance of the company's chartered purposes, and within the powers impliedly delegated to the board of directors.³

§ 424. **Exceptions to the Rule.**—A payment which is really for the benefit of the corporate enterprise is authorized, although it be in the form of a gratuity.⁴ Thus, in *Taunton v. Royal Insurance Co.*,⁵ a shareholder of an in-

¹ *Monument Nat. Bank v. Globe Works*, 101 Mass. 57; *Lafayette Sav. Bank v. St. Louis Stoneware Co.*, 2 Mo. App. 299; *Bank of Genesee v. Patchin Bank*, 13 N. Y. 309; *Morford v. Farmers' Bank*, 26 Barb. 568; *Savage Manuf. Co. v. Worthington*, 1 Gill, 284; *West St. Louis Sav. Bank v. Shawnee County Bank*, 95 U. S. 557; *Ætna Nat. Bank v. Charter Oak Life Ins. Co.*, 50 Conn. 167; *Culver v. Reno Real Estate Co.*, 91 Pa. St. 367; *Beecher v. Dacey*, 45 Mich. 92. See also *Davis v. Old Colony R. R. Co.*, 131 Mass. 258.

"No one member of a firm can bind it, without the consent of all its members, by signing the copartnership name as drawer, maker, acceptor, or indorser of negotiable paper for the accommodation of a third party, for the obvious reason that such a transaction is not within the scope of copartnership business, unless expressly or impliedly made so, and would ordinarily be without authority and in fraud of

the firm." 1 *Daniel on Neg. Instruments*, § 365.

² *Smead v. Indianapolis, &c. R. R. Co.*, 11 Ind. 104; *Madison, &c. Plank Road Co. v. Watertown, &c. Plank Road Co.*, 7 Wis. 59. A general authority to aid a connecting road is sufficient to authorize a guaranty of its bonds. *Zabriskie v. Cleveland, &c. R. R. Co.*, 23 How. 381; *Smead v. Indianapolis, &c. R. R. Co.*, 11 Ind. 104.

³ *Low v. California Pac. R. R. Co.*, 52 Cal. 53; *Opdyke v. Pacific R. R. Co.*, 3 Dill. 55; *Arnot v. Erie Ry. Co.*, 5 Hun, 610, 611; 67 N. Y. 315.

⁴ *Clarke v. Imperial Gaslight, &c. Co.*, 4 B. & Ad. 315; *Lambert v. Northern Ry. Co.*, 18 W. R. 180.

⁵ 2 H. & M. 135. In *Atty.-Gen. v. Great Eastern Ry. Co.*, L. R. 11 Ch. D. 480, Lord Justice James, referring to the case above cited, said: "I recollect a case of an attempt being made to restrain an insurance company from paying or contributing to losses which were not techni-

insurance company applied for an injunction to restrain the directors of the company from paying losses for which the company was not liable by reason of an exception contained in the policy of insurance; but the court held that, inasmuch as it was usual, and for the benefit of the business reputation of the company, to make such payments, the complainant was not entitled to relief. Vice-Chancellor Page-Wood said: "It is said the payment is a mere gratuity. Let it be so called; it does not follow that it is beyond the power of the company, if to give such gratuities be the generally received method of conducting such a business. Even the case put, of subscribing to a school, would, in my opinion, be a legitimate application of money, if it were proved to be the received mode of carrying on a particular business. . . . It is one thing to say that the directors are paying something which they are not bound to pay, and quite another thing to say that they are making payments for purposes not within the objects of the company."

There can be no doubt that any corporation may enter into a compromise; and the payment of a claim by the agents of a corporation in good faith, for the purpose of avoiding litigation, will not be held unauthorized merely because the claim was not a just one.¹

The directors of a corporation may offer a reward for the apprehension of a thief who has stolen the company's property, and may pursue and cause the arrest and punishment of the offender by the usual course of proceedings.² This must be deemed impliedly authorized by the company's charter, because it is a reasonable means of protecting the company from the loss of its property.

§ 425. What may be received in Payment of Stock Subscriptions and Debts.—The directors of a corporation have implied

cally covered by the terms of their insurances, but it was answered by the court, that such liberality was a legitimate mode of preserving and increasing their customers."

¹ First Nat. Bank v. National Exchange Bank, 92 U. S. 122; New

Albany v. Burke, 11 Wall. 96; Seeley v. San Jose, &c. Co., 59 Cal. 22.

² Kelsey v. National Bank, 69 Pa. St. 426; American Express Co. v. Patterson, 73 Ind. 430; Ricord v. Central Pacific R. R. Co., 15 Nev. 167.

authority to call in the capital subscribed by its shareholders, whenever this is needed in carrying on the company's business.¹ The money so obtained may be applied in purchasing such property as is necessary or appropriate as a means of attaining any of the company's authorized purposes. It is also within the powers of the directors to receive property in lieu of a payment due the company, whether from a stockholder or an ordinary debtor, provided the property be of such character and value that they would be authorized to purchase it with the money, if this had been first paid into the treasury of the company.² The directors may even accept a payment in property which is not needed in carrying on the company's business, provided this be done in good faith, to prevent the company from suffering loss through the insolvency of a debtor or subscriber; and they may enter into a *bona fide* compromise where the liability of a shareholder or of any debtor of the company is in dispute.³ This follows as an incident to the power of the directors to manage the company's affairs according to the usages of business, and to do all reasonable acts to protect it from the loss of its property.

§ 426. It has been held in various cases, that the agents of a corporation could receive in payment of stock subscriptions either promissory notes with security,⁴ or real

¹ *Supra*, § 143 *et seq.*

² Philadelphia, &c. R. R. Co. v. Hickman, 28 Pa. St. 318; Brant v. Ehlen, 59 Md. 1; Reichwald v. Commercial Hotel Co., 106 Ill. 439; Seairight v. Payne, 6 Lea (Tenn.), 283; Hayden v. Atlanta Cotton Factory, 61 Ga. 234; Lorillard v. Clyde, 86 N. Y. 384; Oregonian Ry. Co. v. Oregon Ry. & Nav. Co., 23 Fed. Rep. 232, 244; Van Cott v. Van Brunt, 2 Abb. N. C. 283; 82 N. Y. 535; Schroder's Case, L. R. 11 Eq. 131; Pell's Case, L. R. 5 Ch. 11; Spargo's Case, L. R. 8 Ch. 407; and see cases in following notes. Compare, however, Henry v. Vermillion, &c. R. R.

Co., 17 Ohio, 187; Neuse River Nav. Co. v. Newbern, 7 Jones (N. Car.), 275.

A railroad company having authority to purchase a railroad may pay for the same in shares of paid-up stock. Branch v. Jesup, 106 U. S. 468, 481, 484.

³ Philadelphia, &c. R. R. Co. v. Hickman, 28 Pa. St. 318; Macon, &c. R. R. Co. v. Vason, 57 Ga. 314; New Albany v. Burke, 11 Wall. 96.

⁴ Clark v. Farrington, 11 Wis. 306; Lyon v. Ewings, 17 Wis. 61; Andrews v. Hart, Id. 297; Western Bank v. Tallman, Id. 530; Hardy v. Merriweather, 14 Ind. 203; Goodrich

estate,¹ or labor and materials useful in constructing the company's works,² or other property,³ provided it be equal in value to the sum due on the subscription. Paid-up shares may also be issued in payment of debts due from the company, if the directors have authority to issue or sell the shares for an equal amount of cash.⁴

§ 427. **Shares can be declared paid up only on Payment of their Par Amount.** — The rule that shares cannot lawfully be declared paid up unless their par value has been contributed to the company's capital, rests upon the equities existing between the shareholders forming the company and also upon the equitable rights of outside parties, who deal with the company on the faith of the capital indicated by its charter. The charter of a corporation never authorizes the company's agents to issue shares as fully paid up for less than their

v. Reynolds, 31 Ill. 490; *Vermont Central R. R. Co. v. Claves*, 21 Vt. 30. See *People v. Stockton, & Co. v. Hatch*, 1 Disney, 84.

After a corporation has received the note and mortgage of a stock subscriber in payment of his liability, the shares must be regarded as fully paid up, and are transferable as paid-up shares. The maker of the note is liable as an ordinary debtor to the company. *Union, & Co. v. Curtis*, 35 Ohio St. 343; *Protection Life Ins. Co. v. Osgood*, 93 Ill. 69.

It seems questionable, therefore, whether the agents of a corporation should be allowed to receive unsecured promissory notes in payment of shares. So long as shares are not paid up, the company is at least secure that no dividend will be paid the holder or his transferee until the amount of the shares has actually been contributed to the company's capital.

¹ *Cincinnati, & Co. R. R. Co. v. Clarkson*, 7 Ind. 595; *State v. Bai-*

ley, 16 Ind. 46; *Carr v. Le Fevre*, 27 Pa. St. 413; *Dayton, & Co. R. R. Co. v. Hatch*, 1 Disney, 84.

² *Philadelphia, & Co. R. R. Co. v. Hickman*, 28 Pa. St. 318; *Pittsburgh, & Co. R. R. Co. v. Stewart*, 41 Pa. St. 54; *Ashuelot Boot, & Co. v. Hoit*, 56 N. H. 548, 558; *Eppes v. Mississippi, & Co. R. R. Co.*, 35 Ala. 33; *Ridgefield, & Co. R. R. Co. v. Brush*, 43 Conn. 86; *Van Cott v. Van Brunt*, 82 N. Y. 535, overruling 2 Abb. N. C. 283; *Boody v. Rutland, & Co. R. R. Co.*, 24 Vt. 660; *Boston, & Co. R. R. Co. v. Wellington*, 113 Mass. 79.

³ See *Schroder's Case*, L. R. 11 Eq. 131; *East New York, & Co. R. R. Co. v. Lighthall*, 6 Roberts. 407; *Swatara R. R. Co. v. Brune*, 6 Gill, 41; *Louisville, & Co. R. R. Co. v. Thompson*, 18 B. Monr. 735; *Standard v. Shetucket Foundry Co.*, 34 Conn. 542.

⁴ *Lohman v. New York, & Co. R. R. Co.*, 2 Sandf. 39; *Reed v. Hayt*, 51 N. Y. Super. Ct. 121.

actual or market value, because this would be fraud upon the existing shareholders,¹ and it never authorizes the company to represent to the world that its capital has been fully paid up unless it was paid up *at par*, for this would be a fraud upon persons dealing with it.²

§ 428. **Property received must be Money's Worth.** — It follows, therefore, that property cannot be received in payment for more than it is really worth;³ and where property has no ascertained and settled value, it cannot be received at all, unless it be required in carrying on the company's business.⁴

The agents of a corporation who receive property in payment of a stock subscription, or debt due to the company, are not bound at their peril to ascertain whether the value of the property is equal in amount to the indebtedness or liability in payment of which it is received; they are not liable as guarantors of the value of the property. All that is required is, that the agents of the company in receiving the property, and the debtor or stockholder in transferring it, should act in good faith, and should estimate the value of the property with the same care as if it were paid for in cash.⁵

§ 429. **Under Statute in New York.** — The general law of New York for the incorporation of companies for manufacturing, mining, and other purposes, originally contained a provision that nothing but money should be considered as payment of any part of the capital stock of a company formed under the act.⁶ Subsequently, an amendatory act was passed, authorizing the trustees of such a company to purchase any

¹ *Supra*, § 306.

² *Infra*, § 781.

In some States corporations are prohibited by statute or constitutional provision from issuing stock as paid up, except for money or money's worth. See Const. of Cal., Art. XII. § 11; *Ewing v. Oroville Mining Co.*, 56 Cal. 649; *McDonald v. Patterson*, 54 Cal. 245; *Hyatt v. Allen*, Id. 353.

³ *Cabot, &c. Bridge Co. v. Chapin*, 6 Cush. 50; *Oliphant v. Wood-*

burn Coal, &c. Co., 63 Iowa, 332; and see cases *infra*, §§ 825, 826.

⁴ See *Barnes v. Brown*, 11 Hun, 315; *Tasker v. Wallace*, 6 Daly, 364.

⁵ *Lorillard v. Clyde*, 86 N. Y. 384; and see cases cited in the following section.

As to the rights of the corporation and its stockholders where this rule is violated, see *supra*, §§ 289-292. As to the rights of creditors, see *infra*, § 825 *et seq.*

⁶ Act of 1848, ch. 40, sect. 14.

property necessary for the company's business, and to issue stock "to the amount of the value thereof to be paid up."¹ Under this amendment it has been held that to charge a holder of stock, issued as paid up under this act, with individual liability for the debts of the company, was not enough to prove that the property has been purchased and the stock paid up at an over-valuation through some mistake or error of judgment on the part of the trustees, but that it must be shown that the purchase at the price agreed to was in bad faith, and to evade the statute. The transaction may be impeached for fraud, but not for error of judgment or mistaken views of the value of the property, such as good faith and the exercise of an honest judgment are all that is required."²

§ 430. **The Right of carrying on Legal Proceedings.** — It is implied in every charter of incorporation that the company formed under it may engage in legal proceedings, and take whatever steps may be required for the protection and enforcement of its rights. The right to execute an appeal bond, or other undertaking in the course of a litigation, follows as a necessary consequence.³ It is also clear that the managing agents of a corporation have implied authority to employ attorneys and counsellors to represent the company in legal proceedings, and to give legal advice whenever, in the exercise of a reasonable discretion, this would be a prudent measure in the management of the company's affairs.⁴

If a corporation has an interest in the result of a litigation, it may properly support the same out of the corporate funds, although the corporation be not itself a party to the suit. Thus, a corporation may indemnify an agent for expenses incurred in carrying on a suit involving a construction of the

¹ Act of 1853, ch. 333.

³ *Collins v. Hammock*, 59 Ala.

² *Douglass v. Ireland*, 73 N. Y. 448.

100, 102; *Lake Superior Iron Co.*

v. Drexel, 90 N. Y. 87; *Boynton v.*

Andrews, 63 N. Y. 93; *Schenck v.*

Andrews, 57 N. Y. 133; *Boynton*

v. Hatch, 47 N. Y. 225.

⁴ *Western Bank v. Gilstrap*, 45

Mo. 419. See also *infra*, § 535, and

supra, § 356.

company's charter, or a determination of a disputed question affecting the company's rights.¹ The funds of a corporation may also be used in defending a suit brought against an agent on account of acts performed in the service of the company, whenever the corporation is materially interested in the result; as, for example, where there is a reasonable possibility that the corporation may ultimately be compelled to indemnify its agent.²

But the agents of a corporation have no right to use the corporate funds in order to support a litigation which is not for the company's benefit and for an authorized purpose.³ Thus, in *Pickering v. Stevenson*,⁴ the directors of a foreign railway company were enjoined, at the suit of a shareholder, from applying the funds of the company in paying the costs of a prosecution instituted by them on account of a libel concerning their management of the company's affairs.

The managing agents of a corporation have authority to compromise a suit, or to confess judgment, whenever, in the exercise of their discretion, they deem this to be in the interest of the corporation. A provision in the charter of a corporation, providing a particular form of serving process on the company, does not prohibit the execution of a power of attorney to confess judgment waiving service.⁵

§ 431. **The Right to purchase Shares in another Company.**—A corporation has no implied right to purchase shares in

¹ Compare *Baker v. Windham*, 13 Me. 74; *Babbitt v. Savoy*, 3 Cush. 530; *Mayor of Macon v. Cummins*, 47 Ga. 321; *Harbison v. First Presbyterian Society*, 46 Conn. 529; *Regina v. Prest*, 16 Q. B. 33.

² It seems that a town may indemnify an executive officer, out of town funds, for losses sustained while acting in good faith in the discharge of his official duty. *Nelson v. Milford*, 7 Pick. 18; *Hadsell v. Hancock*, 3 Gray, 526; *Merrill v. Plainfield*, 45 N. H. 126.

³ *Daniel v. Mayor of Memphis*,

11 Humph. 582; *Butler v. City of Milwaukee*, 15 Wis. 493; *Regina v. Mayor of Tamworth*, 17 W. R. 231. Compare *Regina v. Town Council of Lichfield*, 4 Q. B. 893; *Regina v. Town Council of Stamford, Id.* 900, *n.*

⁴ *Pickering v. Stephenson*, L. R. 14 Eq. 322; *Vincent v. Nantucket*, 12 Cush. 103; *Merrill v. Plainfield*, 45 N. H. 126; *Harbison v. First Presbyterian Society*, 46 Conn. 529.

⁵ *Millard v. St. Francis, &c. Academy*, 8 Ill. App. 341.

another company for the purpose of controlling its management.¹ Nor may a corporation hold shares in another company as an investment, unless this be the usual method of carrying on its own proper business. The right of a corporation to invest in shares of another company cannot be implied merely because both companies are engaged in a similar kind of business. A corporation must carry on its business by its own agents, and not through the agency of another corporation.² It is clear, also, that a corporation has no implied right to speculate in shares unless this be the kind of business for which the company was formed.³

But a corporation may always, without express authority, acquire shares in another company while carrying on business in the usual manner;⁴ and even although purchasing shares be not within the course of the business of a corporation under ordinary circumstances, it may be entirely proper under exceptional circumstances. Thus, every corporation, irrespective of the nature of its business, would have a right to receive shares given in payment of, or as security for, a claim which is in danger of proving worthless through insolvency of the debtor.⁵

§ 432. No rule can be stated for determining, in all cases, whether or not a corporation may purchase shares in another

¹ *Sumner v. Marcy*, 3 Woodb. & M. 105; *Central R. R. Co. v. Collins*, 40 Ga. 582; *Hazlehurst v. Savannah, &c. R. R. Co.*, 43 Ga. 13; *Great Northern Ry. Co. v. Eastern Counties Ry. Co.*, 21 L. J. Ch. 837. See, however, *Ryan v. Leavenworth, &c. Ry. Co.*, 21 Kans. 365; *Booth v. Robinson*, 55 Md. 419.

² *Mechanics', &c. Ass. v. Meriden Agency Co.*, 24 Conn. 159; *Sumner v. Marcy*, 3 Woodb. & M. 105; *Franklin Co. v. Lewiston Savings Institution*, 68 Me. 43; *Berry v. Yates*, 24 Barb. 199. Compare *Terry v. Eagle Lock Co.*, 47 Conn. 141; *McMillan v. Carson Hill, &c. Mining Co.*, 12 Phila. 404; *Franklin Bank v. Commercial Bank*, 36

Ohio St. 350. In *Milbank v. New York, &c. R. R. Co.*, 64 How. Pr. 20, it was held that a railroad company, having acquired shares in another company, could not vote upon the same, although it could collect the dividends.

³ *First Nat. Bank v. National Exchange Bank*, 92 U. S. 128; *Talmage v. Pell*, 7 N. Y. 328; *Royal Bank of India's Case*, L. R. 4 Ch. 252; *Joint Stock, &c. Co. v. Brown*, L. R. 8 Eq. 381; *Franklin Bank v. Commercial Bank*, 36 Ohio St. 350.

⁴ *Royal Bank of India's Case*, L. R. 4 Ch. 252.

⁵ *First Nat. Bank v. National Exchange Bank*, 92 U. S. 128.

company. Shares are, in reality, the interests belonging to the associates or part owners of the corporate concern; but in many instances they have a fixed value, and are dealt with as tangible property. The right to purchase and hold shares, therefore, depends upon the precise character of the shares and the circumstances of the case. Thus, a corporation whose charter authorizes it to invest its funds in an enterprise not requiring the direct supervision of its agents, would be entitled to do this indirectly by purchasing shares in another company, but would have no right to buy shares for speculation. A corporation having authority to lend money on security would be entitled to receive shares of approved value as security, but would have no right to hold them to obtain the dividends, or in the hope of a speculative increase of their value. On the other hand, a corporation engaged in the business of buying and selling shares as a speculation would have no right to acquire them for any other purpose.

§ 433. **Subscribing for Shares in another Company.**—A corporation cannot, in the absence of express statutory authority, become an incorporator by subscribing for shares in a new corporation; nor can it do this indirectly through persons acting as its agents or tools.¹ The right of forming a corporation is conferred by the incorporation laws only upon persons acting individually, and not upon associations; moreover, it would, under ordinary circumstances, be in violation of the charter of an existing company to subscribe for shares in a new company and assume the resulting liabilities.

§ 434. **A Corporation has no Implied Authority to alter the Amount of its Capital Stock, or to purchase Shares of its own Stock.**—A corporation has no implied authority to alter the amount of its capital stock, where the charter has definitely fixed the capital at a certain sum. The shares of a corporation can neither be increased nor diminished in number, or in their nominal value, unless this be expressly authorized by the company's charter.²

¹ *Central R. R. Co. v. Pennsylvania R. R. Co.*, 31 N. J. Eq. 475. 430; *Droitwich Salt Co. v. Curzon*, L. R. 3 Exch. 42; *Re Financial*

² *Smith v. Goldsworthy*, 4 Q. B. Corporation, *Holmes's Case*, L. R.

It follows, for this reason, that a corporation can have no right to purchase shares in itself, unless expressly authorized by its charter to do so; for such purchase would diminish the amount of the company's capital, and involve a rescission of the contract of membership.¹ If, however, the charter of a corporation expressly provides that the company may alter or diminish the amount of its capital stock, there seems to be no reason why this should not be done by purchasing a portion of the company's outstanding shares.

There are exceptional cases in which a corporation may become a purchaser or transferee of shares in its own stock, although its charter does not authorize a reduction of capital; as, for example, where the shares are received in discharge of a debt which cannot be collected in any other manner, or where the shares are received as a gift, and the company's real capital therefore remains undiminished.² It is clear that the directors of a corporation have no right, under any circumstances, to purchase shares in the company with the company's own money, for the purpose of controlling the election of officers. Shares in a corporation which have been purchased by the company itself, either in its own name or the name of a trustee, cannot be voted on by either the trustee or the company's officers.³

2 Ch. 714; *New York, &c. R. R. Co. v. Schuyler*, 34 N. Y. 30; *Salem Mill Dam Co. v. Ropes*, 6 Pick. 23; *Knowlton v. Congress, &c. Spring Co.*, 14 Blatchf. 364; *Scovill v. Thayer*, 105 U. S. 143; *Grangers' Life, &c. Ins. Co. v. Kamper*, 73 Ala. 325; and see *infra*, §§ 761, 763.

A provision in the charter of a corporation authorizing the directors to increase its capital stock does not authorize a subsequent reduction. *Sutherland v. Olcott*, 95 N. Y. 93.

In *Railway Co. v. Allerton*, 18 Wall. 235, Justice Bradley said: "A corporation, like a partnership, is an association of natural persons who contribute a joint capital for a common purpose; and although the

shares may be assigned to new individuals in perpetual succession, yet the number of shares and amount of capital cannot be increased, except in the manner expressly authorized by the charter or articles of association. . . . Changes in the purpose and object of an association, or in the extent of its constituency or membership, involving the amount of its capital stock, are necessarily fundamental in their character, and cannot, on general principles, be made without the express or implied consent of its members."

¹ *Supra*, § 112.

² *Supra*, § 114.

³ *Ex parte Holmes*, 5 Cow. 426; *Brewster v. Hartley*, 37 Cal.

In reducing the capital stock of a corporation, the rights of creditors must always be respected. Existing creditors would be entitled to retain the benefit of the full security on the faith of which they have contracted. It would be a fraud upon those dealing with the company, after a reduction of its capital by the purchase of shares or otherwise, to represent the capital as being greater than the sum to which it has been reduced.¹

PART III.

PAYMENT OF DIVIDENDS.

§ 435. **Dividends may be paid out of Profits.**—The ultimate object for which every ordinary business corporation is formed is the pecuniary profit of its individual members.² Any net increase of the capital of an institution of this kind is a gain upon the united investment of its shareholders, and may be distributed amongst them as profits, each shareholder being entitled to his proportionate dividend or share.

It is a fundamental rule, that dividends can be paid only out of profits or the net increase of the capital of a corporation, and cannot be drawn upon the capital contributed by the shareholders for the purpose of carrying on the company's business. If the capital stock of a corporation is fixed by its charter at a certain amount, the company has no legal authority to begin to carry on business with a less capital; nor do the members of a corporation of this description agree to unite in any corporate speculation until the amount of capital indicated by the charter has been fully subscribed.³ For the same reasons, it follows that the capital of a corporation cannot be reduced wilfully below the amount fixed by the charter, after the company has begun to carry on business. The managing agents, and even the holders of a ma-

15. Compare *Taylor v. Miami Exp. Co.*, 6 Ohio, 76.

¹ *Infra*, § 851.

² This does not apply to savings banks. See *supra*, § 390.

³ *Supra*, § 408.

jority of shares, have no authority to diminish the prescribed capital of the company by distributing a portion of it among the shareholders in the shape of dividends. This would not only be in violation of the rights of every dissenting member, but would be a fraud upon creditors; and the latter would be entitled to treat such dividend as a repayment *pro tanto* of the capital pledged as security for their claims, and not as an irrevocable distribution of profits.¹

Accordingly, it has been held that, if the agents of a corporation repay to its stockholders any portion of the fund originally contributed as capital, the corporation may recover the amount paid, as money paid by its agents without any authority.² And if the managing agents of a corporation threaten to distribute any portion of its funds amongst the stockholders before a net increase has been realized, any dissenting stockholder may interfere on behalf of the company, in order to protect his equitable rights.³

§ 436. **Under New York Statutes.**—In New York it is provided by statute that the directors or managers of a corporation shall make no dividend except from surplus profits, and shall not divide, withdraw, or in any manner pay to the stockholders, any portion of the company's capital stock.⁴ By the terms of the Penal Code, any director who concurs in making a dividend not allowed by law, or in dividing, withdrawing, or paying to the stockholders any part of the company's capital stock, is guilty of a misdemeanor.⁵

§ 437. **What may be distributed as Net Profits.**—It is often a matter of practical difficulty to determine what the actual profits of a corporation are, but the method of calculation is

¹ *Infra*, § 789. The rule here stated is not applicable to corporations whose capital is not provided as a permanent fund for carrying on business. *Infra*, §§ 442, 830.

² *Lexington, &c. Ins. Co. v. Page*, 17 B. Monr. 412, 442, 443. See *Rance's Case*, L. R. 6 Ch. 104.

³ See *Macdougall v. Jersey Im-*

perial Hotel Co., 2 H. & M. 528, and cases *supra*, § 276.

⁴ R. S. of N. Y., Part I. Ch. XVIII. Title IX. § 2. (L. 1825, ch. 448, § 2.) As to the construction of this provision, see *Williams v. Western Union Tel. Co.*, 93 N. Y. 162.

⁵ New York Penal Code, § 594.

extremely simple. Vice-Chancellor Sandford said: "The capital stock of a corporation is, like that of a copartnership or joint-stock company, the amount which the partners or associates put in as their stake in the concern. To this they add, upon the credit of the company, from the means and resources of others, to such extent as their prudence or the confidence of such other persons will permit. Such additions create a debt; they do not form capital. And, if successful in their career, the surplus over and above their capital and debts becomes profits, and is either divided among the partners and associates, or used still further to extend their operations."¹

The rule was stated by Blatchford, J., with special reference to the case of a railroad company, as follows: "Net earnings are, properly, the gross receipts less the expenses of operating the road to earn such receipts. Interest on debts is paid out of what thus remains, that is, out of the net earnings. Many other liabilities are paid out of the net earnings. When all liabilities are paid, either out of the gross receipts or out of the net earnings, the remainder is the profit of the shareholders to go towards dividends, which in that way are paid out of the net earnings."²

§ 438. **Method of ascertaining Profits.**—The right to declare a dividend depends upon the state of the company's finances at the time when the dividend is declared. The question usually is, whether or not there would remain a net increase upon the original investment, after deducting from the assets of the company, all present debts and making provision for future or contingent claims.³ It is immaterial at what time the increase was earned. Profits accumulated by a corporation in times of prosperity may be

¹ *Barry v. Merchants' Exchange Co.*, 40 Ga. 103; *People v. Supervisors*, 4 Hill, 20. See *Union Pacific R. R. Co. v. United States*, 99 U. S. 426; *Stringer's Case*, L. R. 4 Ch. 475.

² *St. John v. Erie Ry. Co.*, 10 Blatchf. 271, 279; 22 Wall. 136. See also *Reid v. Eatonton Manuf.*

³ See cases in the following sections.

distributed by the company subsequently, when no profits are earned.¹

A corporation may be largely indebted, and yet be entitled to pay dividends to its shareholders before the indebtedness has been paid,² and it may even be proper to borrow money for the purpose of paying a dividend, provided a surplus would remain after deducting the amount of the company's capital and indebtedness from the fair value of the assets which it owns.³

§ 439. In ascertaining whether a company has a surplus which may be divided among the shareholders, permanent improvements made by means of borrowed money may often be valued as counterbalancing the liability of the company for the money used to construct them.⁴ Machinery or rolling stock purchased by a railroad company may be taken as representing the amount of capital invested in it, after making due allowance for depreciation in value through accident and wear.⁵

Future and contingent claims against a corporation must be reduced to their present value, in order to determine the net gain upon the capital invested. Hence, it is the duty of the directors of an insurance company to reserve at all times a sufficient fund, in addition to the capital stock, to meet probable losses on risks assumed by the company.⁶

If the entire capital has not been paid in by the shareholders, the amount remaining unpaid should be treated as a reserve fund, and be added to the assets on hand, in deter-

¹ See *Williams v. Western Union Tel. Co.*, 93 N. Y. 162; *Mills v. Northern Ry. Co.*, L. R. 5 Ch. 621; *Beers v. Bridgeport Spring Co.*, 42 Conn. 17; *Hoole v. Great Western Ry. Co.*, L. R. 3 Ch. 268.

² *Mills v. Northern Ry. Co.*, L. R. 5 Ch. 631. ⁵ *Mills v. Northern Ry. Co.*, L. R. 5 Ch. 631. Compare *Corry v. Londonderry, &c. Ry. Co.*, 29 Beav. 272, 273.

³ *Stringer's Case*, L. R. 4 Ch. 475. See *infra*, § 838.

⁴ *Corry v. Londonderry, &c. Ry. Co.*, 29 Beav. 272. See *Bardwell v. Sheffield Water Works Co.*, L. R. 14 Eq. 521.

⁶ *Scott v. Eagle Fire Co.*, 7 Paige, 198; *De Peyster v. American Fire Ins. Co.*, 6 Paige, 486; *Lexington, &c. Ins. Co. v. Page*, 17 B. Monr. 412.

mining whether the company has a surplus with which it can pay a dividend.

§ 440. **Dividends where the Capital has been reduced in Value.**—The right of a corporation to declare dividends cannot be determined by reference to the market value of the company's shares, or the price for which its assets could be sold. After the capital of a corporation has been invested in property, to be used in carrying on its business, the value of the company's assets and of its shares would be a purely speculative one, depending upon the success of the enterprise.

In determining whether a company is entitled to pay a dividend to its shareholders, the property acquired for permanent use in carrying on business, may be valued at the price actually paid for it, although it could not be sold again except at a loss. And even although the business of the company should prove less profitable than was anticipated, and the value of the whole concern, and consequently of the shares representing it, should greatly depreciate in actual value, it would not be necessary to accumulate the profits until the depreciation had been made up, and the value of the shares again raised to par. All that is required is, that the whole capital originally contributed by the shareholders shall be put into the business and kept there; that no part of it shall be taken out again, directly or indirectly, and given back to the shareholders.

§ 441. The rule above stated applies to all corporations whose capital is intended to provide a permanent means of carrying on business; it applies to banking, manufacturing, railroad, telegraph, and insurance corporations, and to all companies of a similar character. If the capital of a company of this description is invested in machinery, land, or fixtures used in carrying on its business, the machinery, land, or fixtures may be valued at their original cost, provided they be kept up in their original condition.

Any depreciation of the value of the company's property resulting from the uncertainty of the speculation in which the company has embarked, or from a failure to carry on business profitably by reason of the state of trade, or similar

causes, may be disregarded; but any depreciation caused by design, accident, or wear and tear in using the property, should be made up out of the earnings before any dividend is declared.

The capital of some classes of corporations, such as banking and insurance companies, is not contributed for the purchase of machinery or fixtures of any kind, except to a very limited amount, but is provided as a fund of money to be used by the company solely in money transactions. It is evident that no material depreciation of the value of the capital of a company of this description can take place except through losses sustained in business transactions. The fund provided for carrying on the business should therefore be kept up at its original amount; and if it has been reduced by losses, no dividend should be declared until the losses have been repaired.¹

§ 442. **Different Rule applicable to Mining Companies.** — The rule stated in the preceding section has no application to a corporation whose sole purpose is to invest its capital in a specific piece of property like a mine, and afterwards to consume the property or extract its value at a profit. The capital of a mining company is not designed to be used, like that of a banking or manufacturing company, in carrying on business permanently. The working of a mine necessarily causes it to become exhausted and to depreciate in value, and this depreciation cannot be repaired. There would be no object in accumulating the money obtained by the company through working the mine, so as to keep up the original amount of

¹ In New York the rule above stated applies to moneyed corporations by statutory enactment. Section 182 of the banking law provides: "When any losses shall be sustained by any such corporation, that shall exceed its undivided profits then realized and possessed, they shall be charged as a reduction of the capital stock of the company, and no dividend shall thereafter be made on the shares of such stock until the

deficit of capital so created shall be made good, either by the recovery of the moneys charged as lost, or from the subsequently accruing profits of the company." Act of 1882, ch. 409, re-enacting sections 3 and 4 of Title II. Chap. XVIII. of Part I. of R. S.

The rule thus enacted appears to be the rule applicable to companies of this description at common law.

capital. It is implied from the character of the speculation of a mining company, that the income derived from working the mine shall be distributed among the shareholders as dividends, after deducting the expenses, and making reasonable provision for contingencies.¹

But a mining company has no right to draw upon its capital by borrowing money, or by selling a portion of its property, in order to declare a dividend.² It can only use the net proceeds of working the mine for this purpose, and clearly no dividend can be declared without considering the rights of creditors, and providing for future liabilities.

§ 443. **Distribution of Capital.** — Money obtained by a company upon the sale of forfeited stock,³ or as compensation for property taken under the power of eminent domain,⁴ or as interest or penalty on account of the failure of a contractor to complete his work,⁵ cannot be treated as profits, and divided among the shareholders, without reference to the general state of the company's finances.

If the nominal capital stock of a corporation has been reduced by the proper authorities, the shareholders are entitled to have any excess of the actual capital on hand over the reduced amount of the nominal capital divided amongst them in proportion to the number of their shares. The sum thus divided does not constitute profits, nor is it a part of the capital of the newly organized company. It is merely a part of the fund originally invested by the shareholders, which they are entitled to have restored to them, or applied according to their agreement, after the original investment has been abandoned.⁶ Upon winding up a corporation, the entire capital after paying the company's debts must be distributed among the shareholders;⁷ in this case, the rules governing

¹ See *infra*, § 830.

² *Davis v. Flagstaff Silver Mining Co.*, 2 Utah, 74.

³ *Gratz v. Redd*, 4 B. Monr. 187.

⁴ *Semble*, *Heard v. Eldredge*, 109 Mass. 258.

⁵ *Bloxam v. Metropolitan Ry. Co.*, L. R. 3 Ch. 337.

⁶ *Seeley v. New York Nat. Exch. Bank*, *Thompson's Nat. Bank Cases*, 804; 8 Daly, 400; affirmed, 78 N. Y. 608; *Strong v. Brooklyn, &c. R. R. Co.*, 93 N. Y. 426. See *Parker v. Mason*, 8 R. I. 427.

⁷ *Supra*, §§ 415, 416.

the distribution of profits and payment of dividends have no application.

§ 444. **Agreements to pay Interest to Shareholders.** — There is an obvious difference between dividends paid to the shareholders of a corporation, and interest paid to bondholders or creditors who have loaned their money to the company. The money contributed by the shareholders constitutes an investment fund created for their mutual benefit. The fund thus created belongs to the shareholders in equity; any increase is their profit, any depreciation is their loss. To distribute any portion of this fund among the shareholders in the form of interest would be paying them out of their own money, by reducing the amount of their working capital. It is a rule that the capital of a corporation cannot lawfully be reduced by distribution among the shareholders in any form, until the business of the company is wound up.¹ An agreement to pay dividends or interest to the shareholders of a corporation, without reference to the ability of the company to pay the same out of profits or the net increase of its capital, is therefore, wholly unauthorized.²

But a corporation may properly stipulate that each shareholder shall be entitled to interest on the amount paid upon

¹ A loan to the shareholders, of capital not needed by the company in its business, would not necessarily be unauthorized. This would not be a reduction of capital, as the shareholders would remain liable to restore the money loaned. It would be an investment of corporate funds.

² *Lockhart v. Van Alstyne*, 31 Mich. 76; *Painesville, &c. R. R. Co. v. King*, 17 Ohio St. 534; *Troy, &c. R. R. Co. v. Tibbits*, 18 Barb. 297; *Pittsburg, &c. R. R. Co. v. County of Allegheny*, 63 Pa. St. 126, 135; *Macdougall v. Jersey Imperial Hotel Co.*, 2 H. & M. 528; *Salisbury v. Metropolitan Ry. Co.*, 38 L. J. Ch. 249.

In *Miller v. Pittsburgh, &c. R. R.*

Co., 40 Pa. St. 239, *Woodward, J.*, said: "This company conformed to the foolish practice of receiving subscriptions on a guaranty that they would pay interest on stock 'as soon as paid,' until the road is finished. When it is considered that railway companies are joint-stock associations, and depend on borrowing most of the money they expect to expend, the absurdity of borrowing money to pay interest to themselves is self-evident. They never borrow at less than from seven to ten per cent, and, in so far as the money is used to pay themselves six per cent on their stock, it is manifestly a ruinous, as well as absurd operation."

his shares while the works of the company are in process of construction, provided such interest be made payable only out of the net income or profits which the company may earn. The justice of an agreement of this character was clearly shown by Peck, J., in *Richardson v. Vermont, &c. R. R. Co.*¹ "In the early stages of such undertakings, the use of money for the construction of the road may be presumed to be worth the legal interest; and therefore he who pays early practically contributes more than he who pays the same sum late. This arrangement for the payment of interest, or interest dividends, so called, is equitable and just, as it is but a mode of distributing benefits among the stockholders in proportion to the aid they have respectively contributed to the common enterprise, and thus producing equality between them. Equality is equity as between the stockholders; and such payment, made only out of the surplus earnings not needed for the payment of debts of the corporation nor for the prosecution of its business, does not interfere with the rights of creditors, nor contravene any principle of public policy. It is no more withdrawing capital from the corporation than would be the payment of ordinary dividends, to which purpose the fund would otherwise be appropriated."

If a corporation agrees that its shareholders shall be allowed interest upon the sums contributed by them during the construction of the company's works, but no time of payment is fixed, it will be implied that such interest shall be payable whenever a sufficient amount of net profits have been earned.² And for the same reason it has been held that a holder of preferred shares guaranteeing the payment of semiannual dividends of five per cent is entitled to be paid

¹ *Richardson v. Vermont, &c. R. R. Co.*, 44 Vt. 618, 618; *Rutland, &c. R. R. Co. v. Thrall*, 35 Vt. 543; *Wright v. Vermont, &c. R. R. Co.*, 12 Cush. 75; *Waterman v. Troy, &c. R. R. Co.*, 8 Gray, 433; *Cunningham v. Vermont, &c. R. R. Co.*, 12 Gray, 411; *Barnard v. Vermont, &c. R. R. Co.*, 7 Allen, 512; *Evansville, &c. R. R. Co. v. Evansville*, 15 Ind. 414, 415; *McLaughlin v. Detroit, &c. Ry. Co.*, 8 Mich. 100.

² *Rutland, &c. R. R. Co. v. Thrall*, 35 Vt. 543; *Waterman v. Troy, &c. R. R. Co.*, 8 Gray, 433.

only out of net profits earned by the company.¹ But if the profits realized in any one year are not sufficient to pay the amount promised, the deficiency must as a rule be made up out of profits earned at a subsequent time.²

§ 445. **Dividends are irrevocable.** — A dividend properly declared by the directors of a corporation cannot subsequently be revoked; those persons who were shareholders on the books of the company at the time when the dividend was declared, have a legal claim against the company for the payment of the amount of the dividend.³ After profits have been set apart and appropriated to the payment of a dividend, they belong to the shareholders, and cannot be recalled, although the company should suffer losses and become insolvent before the dividend is actually paid.⁴

But profits remain a part of the fund constituting the company's capital, until set apart and appropriated to the payment of a dividend; and if the general fund is reduced by losses before the profits have been set apart and appropriated, only the actual surplus can be divided, after taking a new account of the company's condition.⁵

§ 446. **Powers of Directors to determine whether a Surplus exists.** — The power of determining whether a corporation has earned a surplus which would warrant the payment of a dividend, is vested in the board of directors. In exercising this power the directors cannot act arbitrarily; they must make an investigation of the affairs of the corporation, and must in good faith apply the principles which have been indicated in the preceding sections.

But the directors cannot be held responsible for a mere mis-

¹ Lockhart v. Van Alstyne, 31 Mich. 76, 84; Taft v. Hartford, &c. R. R. Co., 8 R. I. 310, 333; Bates v. Androscoggin, &c. R. R. Co., 49 Me. 491; and see cases *infra*, § 457.

² *Infra*, § 458.

³ *Supra*, §§ 162, 170.

⁴ See Le Roy v. Globe Ins. Co., 2 Edw. Ch. 657, and *Re* Le Blanc,

14 Hun, 8, where the company became insolvent after a dividend had been declared and placed in the hands of a banker, but had not been paid over to the shareholders. See also King v. Paterson, &c. R. R. Co., 29 N. J. Law, 82.

⁵ Scott v. Eagle Fire Co., 7 Paige, 203; Curry v. Woodward, 44 Ala.

305.

take of judgment in making an erroneous valuation of the company's assets. A dividend declared and paid after a proper investigation of the company's condition and the preparation of a balance-sheet, in good faith, is irrevocable both as to the company and its creditors, though it should afterwards turn out that the company was insolvent at the time when the dividend was declared.¹

§ 447. **The Discretion of the Directors with respect to the Distribution of Profits.** — Profits earned by a corporation *may* be divided among its shareholders; but it is not a violation of the charter if they are allowed to accumulate and remain invested in the company's business. The managing agents of a corporation are impliedly invested with a discretionary power with regard to the time and manner of distributing its profits. They may apply profits in payment of floating or funded debts, or in development of the company's business; and so long as they do not abuse their discretionary powers, or violate the company's charter, the courts cannot interfere.²

But it is clear that the agents of a corporation, and even the majority, cannot arbitrarily withhold profits earned by the company, or apply them to any use which is not authorized by the company's charter. The nominal capital of a company does not necessarily limit the scope of its operations; a corporation may borrow money for the purpose of enlarging its business, and in many instances it may use profits for the same purpose. But the amount of the capital contributed by the shareholders is an important element in determining the limit beyond which the company's business cannot be extended by the investment of profits. If a corporation is formed with a capital of \$100,000 in order to carry on a certain business, no one would hesitate to say that it

¹ Stringer's Case, L. R. 4 Ch. 475; *infra*, § 838.

² See Pratt v. Pratt, 33 Conn. 446; State v. Baltimore, &c. R. R. Co., 6 Gill, 363; Karnes v. Rochester, &c. R. R. Co., 4 Abb. Pr. n. s. 107; Ely v. Sprague, Clarke's

Ch. 351; Barry v. Merchants' Exchange Co., 1 Sandf. Ch. 280, 303; Smith v. Prattville Manuf. Co., 29 Ala. 503; State v. Bank of Louisiana, 6 La. 745. See Stringer's Case, L. R. 4 Ch. 475; and see *supra*, §§ 243, 276.

would be a departure from the intention of the founders to withhold the profits, in order to develop the company's business, until the sum of \$500,000 had been amassed, unless the company was formed mainly for the purpose of accumulating the profits from year to year. The question in each case depends upon the use to which the capital is put, and the meaning of the company's charter. If a majority of the shareholders or the directors of a corporation wrongfully refuse to declare a dividend and distribute profits earned by the company, any shareholder feeling aggrieved may obtain relief in a court of equity.¹

It may often be reasonable to withhold part of the earnings of a corporation in order to increase its surplus fund, when it would not be reasonable to withhold all the earnings for that purpose. The shareholders forming an ordinary business corporation expect to obtain the profits of their investment in the form of regular dividends. To withhold the entire profits merely to enlarge the capacity of the company's business would defeat their just expectations. After the business of a corporation has been brought to a prosperous condition, and necessary provision has been made for future prosperity, a reasonable share of the profits should be applied in the payment of regular dividends, though a part may be reserved to increase the surplus and enlarge the business itself.

§ 448. **How Dividends are Payable.** — Dividends are presumed to be payable in lawful money;² and it seems that, in England, they must be payable in cash.³ But in America the declaration of scrip or stock dividends is a matter of common occurrence.⁴

¹ *Beers v. Bridgeport Spring Co.*, 42 Conn. 17; *Pratt v. Pratt*, 33 Conn. 446; *Scott v. Eagle Fire Co.*, 7 Paige, 203; *State v. Bank of Louisiana*, 6 La. 745; *Browne v. Monmouthshire Ry., &c. Co.*, 13 Beav. 32; *Stevens v. South Devon Ry. Co.*, 9 Hare, 313; *supra*, § 276.

² See *Ehle v. Chittenango Bank*, 24 N. Y. 548; *Scott v. Central R. R., &c. Co.*, 52 Barb. 45.

³ *Hoole v. Great Western Ry. Co.*, L. R. 3 Ch. 262.

⁴ See *State v. Baltimore, &c. R. R. Co.*, 6 Gill, 363; *Brown v. Lehigh Coal, &c. Co.*, 49 Pa. St. 270; *City of Ohio v. Cleveland, &c. R. R. Co.*, 6 Ohio St. 489; *Bailey v. Citizens' Gas Light Co.*, 27 N. J. Eq. 196; and see *infra*, § 452, as to stock dividends.

The board of directors have authority to fix the time and place of payment of dividends; they may deposit the money to pay a dividend with a banking-house of good standing, giving notice to each stockholder of the deposit, and that he can obtain payment on demand.¹

§ 449. **To whom Dividends are Payable.**—The strictly *legal* right to require payment of a dividend is in those persons who were shareholders on the books of the company at the time when the dividend was declared; but the rights of equitable assignees will be protected by the courts.² The agents of a corporation are justified in paying dividends to the shareholders on the company's books, unless notified of the rights of equitable assignees.³

Profits must be divided ratably among all the shareholders; when a dividend is declared, a specific sum should be made payable on each share. A shareholder is entitled to share in all profits divided by the company after he became a member. No discrimination can be made against a shareholder who received his shares from the company after the dividend had been earned; for the price of the shares would have included a proportionate part of the accumulated profits.⁴

§ 450. **Suits for Dividends.**—A shareholder in a corporation has no *legal* claim to profits earned by the company until after a dividend has been declared by the proper agents; nor can he compel the directors to declare a dividend unless they withhold profits which they have no discretionary power to retain for further investment. A suit to enforce the declaration of a dividend must be brought in equity, and all the

¹ King v. Paterson, &c. R. R. Co., 29 N. J. Law, 82.

² *Supra*, § 181.

³ *Supra*, § 170.

⁴ Jones v. Terre Haute, &c. R. R. Co., 57 N. Y. 196; Phelps v. Farmers', &c. Bank, 26 Conn. 269; Ryan v. Leavenworth, &c. Ry. Co., 21 Kans. 365. See Currie v. White, 45 N. Y. 822.

The directors cannot make a dividend payable in cash to all shareholders holding less than fifty shares in each, and partly in bonds to those shareholders holding more than fifty shares. State v. Baltimore, &c. R. R. Co., 6 Gill, 363.

As to preferred shareholders, see *infra*, § 456 *et seq.*

conditions precedent to the right of maintaining an ordinary shareholders' bill must be complied with. However, after a dividend has been declared payable to all shareholders, each shareholder is entitled to recover his distributive share in an action of *assumpsit* against the corporation.

In *King v. Paterson, &c. R. R. Co.*, Chancellor Green, in delivering the opinion of the Supreme Court of New Jersey, said: "After a dividend is declared, all community of interest in relation to such dividend, as between the stockholders themselves and between the stockholders and the corporation, is at an end. The right of a party to whom the dividend is payable is recognized as a separate and independent right, which may be enforced as against the corporation. . . . The true principle is, that the dividend, from the time that it is declared, becomes a debt due from the corporation to the individual stockholder, for the recovery of which, after demand of payment, an action at law may be maintained."¹

§ 451. It has been held that, if a dividend has been declared payable to the shareholders generally, any shareholder may sue in *indebitatus assumpsit* for the amount due to him according to the terms of the resolution declaring the dividend.² But if a shareholder is not entitled to share in a dividend according to the terms of the resolution declaring it, he cannot sue for the amount in *indebitatus assumpsit*;³ under these circumstances, his claim against the corporation

¹ *King v. Paterson, &c. R. R. Co.*, 29 N. J. Law, 82, 504; *West Chester, &c. R. R. Co. v. Jackson*, 77 Pa. St. 321; *Kane v. Bloodgood*, 7 Johns. Ch. 90; *Keppel's Admr. v. Petersburg R. R. Co.*, Chase's Dec. 168. Compare *State v. Baltimore, &c. R. R. Co.*, 6 Gill, 363; *Jackson v. Newark Plank Road Co.*, 31 N. J. Law, 277; *Bank of England v. Davis*, 5 B. & C. 185; *Coles v. Bank of England*, 10 Ad. & E. 437; *Carlisle v. South Eastern Ry. Co.*, 6 Eng. Ry. Cas. 685.

It has been held that the power

of the agents of the company to declare a dividend cannot be investigated in a suit of this description, if this would involve an inquiry into the financial condition of the company. See *Stoddard v. Shetucket Foundry Co.*, 34 Conn. 542; *Scott v. Central R. R., &c. Co.*, 52 Barb. 45.

² *Jackson's Admr. v. Newark Plank Road Co.*, 31 N. J. Law, 277; *West Chester, &c. R. R. Co. v. Jackson*, 77 Pa. St. 321.

³ *State v. Baltimore, &c. R. R. Co.*, 6 Gill, 363.

would be that his rights of membership were infringed by the act of the directors, in declaring the dividend improperly, and refusing him participation in the profits.

A shareholder has no claim upon any part of the specific funds constituting the profits of a corporation until his share has been set apart and appropriated to the payment of his dividend. If a shareholder is ignored in making a dividend, his claim is against the corporation; he cannot sue the other shareholders for contribution out of the money which they have received, nor can he sue a stranger who received the share which should have been paid to him, in an action for money had and received. If the directors have paid dividends to persons not entitled to receive them, the corporation itself must sue for a recovery of the money misappropriated.¹

It has been held that a bill in equity will lie to compel the payment of a dividend which has been declared.² But mandamus is not a proper remedy for this purpose.³

In the absence of any provision to the contrary, dividends are payable only on demand at the proper office of the corporation, and no action can be maintained until the requisite demand has been made.⁴

§ 452. **Stock Dividends.**—A corporation which has earned a surplus may in many instances retain the money for the purpose of making improvements, or for the payment of debts, instead of dividing it among its shareholders. The actual capital of the company is thus increased, while the nominal or share capital remains unchanged; consequently, the value of its shares will be increased. If the charter of a corporation authorizes it to increase the amount of its capital stock by the issue of new shares, this may be done either by receiving new stock subscriptions, or by selling paid-up shares at par, for cash. The only essential is, that each share be represented at its par value by real capital.

¹ *Peckham v. Van Wagenen*, 83 N. Y. 40; 45 N. Y. Super. Ct. 328.

* *Van Norman v. Central Car, &c. Co.*, 41 Mich. 166.

² *Beers v. Bridgeport Spring Co.*, 42 Conn. 17; *Le Roy v. Globe Ins. Co.*, 2 Edw. Ch. 657.

⁴ *State v. Baltimore, &c. R. R. Co.*, 6 Gill, 364; *Hagar v. Union Nat. Bank*, 63 Me. 509; *Scott v. Central R. R., &c. Co.*, 52 Barb. 45.

If then a corporation having power to increase its nominal or share capital has accumulated a surplus which it would be entitled to distribute among its shareholders, it may issue to the shareholders new paid-up shares, to the extent of the surplus on hand, without violating the rule governing the issue of paid-up shares.¹ Thus, if a corporation whose nominal capital is one million dollars allows its earnings to accumulate until the actual capital amounts to two millions of dollars, the value of each share will be doubled. The company may then distribute one million of dollars as profits, thereby reducing the shares to their par value; or it may retain the whole of its earnings, and issue to its shareholders paid-up shares to the extent of one million dollars, instead of distributing cash. The nominal capital of the company will thus be increased to two millions of dollars, and each shareholder will hold two shares at par where he previously held only one worth double the par value.

§ 453. **Whether the Right to make Stock Dividends is conferred by Implication.** — The directors of a corporation have clearly no right to make a stock dividend unless three conditions concur. These are, —

1. The directors must have authority under the company's charter to issue new shares.

2. There must be profits which the corporation may legally distribute among the shareholders.

3. The directors must have the power, in their discretion, to retain these profits for future use.

This last condition must not be forgotten. The directors of a corporation have a discretionary power, to a limited extent, to accumulate the profits of the company; but they

¹ Williams v. Western Union v. Hubbell, 115 Id. 471; Brown v. Tel. Co., 93 N. Y. 162, 189-193; Lehigh Coal, &c. Co., 49 Pa. St. Howell v. Chicago, &c. Ry. Co., 270; Commonwealth v. Pittsburg, 51 Barb. 378; Jones v. Terre Haute, &c. Ry. Co., 74 Pa. St. 83; Terry v. &c. R. R. Co., 57 N. Y. 196; Kenton Furnace, &c. Co. v. McAlpin, Eagle Lock Co., 47 Conn. 141; Re Barton's Trust, L. R. 5 Eq. 239; 5 Fed. Rep. 743; Atty.-Gen. v. Mills v. Northern Ry., &c. Co., L. R. State Bank, 1 Dev. & B. Eq. 545; 5 Ch. 621. Minot v. Paine, 99 Mass. 101; Rand

cannot go on accumulating them indefinitely. After a reasonable limit has been reached, every shareholder has a right to insist that they shall be distributed as dividends.¹

Moreover, it may be doubted whether the directors of a corporation, or even the majority of the shareholders, have implied authority to capitalize profits by issuing a stock dividend, even though they be authorized to retain the profits in the company's business, and to issue new shares. Profits which are merely retained by a corporation in its business, without a corresponding increase of share capital, may at any time be withdrawn and distributed among the shareholders.² But after a stock dividend has been made on account of accumulated profits, these profits become *permanently* capitalized, and can no longer be withdrawn for distribution. After the nominal capital of a corporation has been increased by the issue of new shares, in the form of a stock dividend or otherwise, further dividends can be declared only out of profits added to the increased capital.

The power of the directors of a corporation or the majority of the shareholders to capitalize profits by issuing stock dividends, is certainly not without limit, even where this power is held to exist. To accumulate the profits beyond the amount contemplated at the creation of a company, by issuing stock dividends from time to time, would not be authorized, unless all the shareholders give their assent.³

§ 454. **Rights of Shareholders when new Shares are issued.**—When a corporation declares a stock dividend in wholly or partially paid-up shares, the new shares are paid up in whole or in part out of the profits which belong to the existing shareholders. It is evident, therefore, that each share-

¹ *Supra*, § 447.

² *Supra*, § 438. But the directors would have no right to withdraw accumulated profits for distribution at a time or in a manner evidently disadvantageous to the company; they must in good faith exercise their best judgment in the interest of the company.

³ This point was not considered in *Williams v. Western Union Tel. Co.*, 93 N. Y. 163, 192. It was not claimed in that case that the directors had exceeded their discretionary power of accumulating profits, or that an excessive accumulation of profits was threatened.

holder is entitled to share in the dividend, to the same extent as if it were paid in cash. It is equally clear, that a corporation cannot issue new shares at less than their full market value, except by equal distribution among all the shareholders; for whatever the new shares are worth is represented by capital or profits belonging in equity to the existing shareholders.¹

§ 455. **Right of Pre-emption.**—It seems that, if a corporation resolves to increase the amount of its capital by issuing and selling new shares, every stockholder has a right of pre-emption of a fractional part of the new issue, proportionate to his fractional share in the company's entire stock.² Each stockholder is thus enabled to preserve unimpaired his voice in the management of the company's affairs. But this applies only where the nominal capital of the company is increased; if shares once issued by a corporation come back into its possession, there is no reason why they should not be sold in the market.³

If a stockholder fails to exercise his privilege to take and pay for his part of a new issue of shares within the time limited by the board of directors, or the vote ordering the new issue, his right of pre-emption becomes forfeited, and the shares may be disposed of by the corporation by sale or subscription in the usual manner.⁴

§ 456. **Preferred Shareholders.—Their Rights.**—Shares which confer upon the holder special privileges or benefits that do not belong to the other members of the corporation are called preferred or preference shares. The precise nature of the

¹ *Jones v. Morrison*, 31 Minn. 78; *Wilson v. Bank of Montgomery* 140; *Page v. Smith*, 48 Vt. 289; *County*, 29 Pa. St. 537; *Mason v. Gray v. Portland Bank*, 3 Mass. 364. *Davol Mills*, 132 Mass. 76. *Contra*,

² *Eidman v. Bowman*, 58 Ill. 444; *Ohio Ins. Co. v. Nunnemacher*, 15 Jones *v. Morrison*, 31 Minn. 140; Ind. 294.

and see *semble*, *Gray v. Portland Bank*, 3 Mass. 364; *Matter of Wheeler*, 2 Abb. Pr. n. s. 361; *State v. Smith*, 48 Vt. 290; *Hartridge v. Rockwell*, R. M. Charlton, 260.

Miller v. Illinois Central R. R. Co., 24 Barb. 312. Compare *Curry v. Co.*, 30 La. Ann. 758; *Brown v. Scott*, 54 Pa. St. 270; *Reese v. Bank of Montgomery County*, 31 Pa. St. 472. ⁴ *Hart v. St. Charles Street R. R. Co.*, 19 Fla. Southern Ry. Co., 19 Fla.

privileges or benefits thus conferred depends upon the terms of the resolution under which the shares are issued, and the form of the certificates delivered to the holders.¹ The most common preference is in respect to the payment of dividends. Thus it is often provided that the holders of the preferred shares shall have priority in the distribution of profits, and shall receive annual dividends at a specified rate before the other shareholders receive anything; the payment of these dividends is sometimes expressly guaranteed.²

§ 457. **Their Dividends payable only out of Profits.**—The agreement of a corporation to pay to preferred shareholders certain annual dividends, is always subject to an implied condition that the payments shall be made only out of net profits which are legally applicable to the payment of dividends. This is true whether the agreed payments be called “dividends” or “interest,” and whether they be guaranteed or simply promised.³ It would be contrary to fundamental principles to allow the capital of a corporation to be reduced by distribution among the shareholders in any form.⁴

¹ For examples see *Bailey v. Hannibal, &c. R. R. Co.*, 1 Dill. 174; 17 Wall. 96; *Matthews v. Great Northern Ry. Co.*, 28 L. J. Ch. 375; *Williston v. Michigan Southern R. R. Co.*, 13 Allen, 400; *St. John v. Erie Ry. Co.*, 22 Wall. 136; 10 Blatchf. 271; *West Chester, &c. R. R. Co. v. Jackson*, 77 Pa. St. 321; *State v. Cheraw, &c. R. R. Co.*, 16 S. Car. 524.

² With regard to the meaning of the words “preference,” “preferred,” and “guaranteed,” when used in this connection, see *Henry v. Great Northern Ry. Co.*, 4 K. & J. 1, 21; *Taft v. Hartford, &c. R. R. Co.*, 8 R. I. 310, 333; *Lockhart v. Van Alstyne*, 31 Mich. 76; *Matthews v. Great Northern Ry. Co.*, 28 L. J. Ch. 375; *Stevens v. South Devon Ry. Co.*, 9 Hare, 313; *Gordon's Exrs. v. Richmond, &c. R. R. Co.*, 78 Va. 501.

³ *Taft v. Hartford, &c. R. R. Co.*, 8 R. I. 310, 333; *Lockhart v. Van Alstyne*, 31 Mich. 76, 84; *Chaffee v. Rutland R. R. Co.*, 55 Vt. 110, 125; *Barnard v. Vermont, &c. R. R. Co.*, 7 Allen, 519; *Cunningham v. Vermont, &c. R. R. Co.*, 12 Gray, 411; *Waterman v. Troy, &c. R. R. Co.*, 8 Gray, 433; *Wright v. Vermont, &c. R. R. Co.*, 12 Cush. 68; *McGregor v. Home Ins. Co.*, 33 N. J. Eq. 181; *Elkins v. Camden, &c. R. R. Co.*, 36 N. J. Eq. 233. See also *supra*, § 444, and cases cited in the note to § 458. Compare *Gordon's Exrs. v. Richmond, &c. R. R. Co.*, 78 Va. 501.

⁴ See *infra*, Chapter X.

An absolute right to receive interest may undoubtedly be given to part of the shareholders of a corporation, by express provision of their charter. They would thus be constituted creditors of the company,

§ 458. **When Arrears must be made up.** — If a corporation has agreed or guaranteed that the holders of preferred shares shall be paid dividends at a certain rate per annum, and the profits at any time are insufficient to enable the company to perform its agreement, the arrears must be made up out of profits subsequently earned; and no dividends can be paid to the holders of the common shares until the preferred shareholders have been fully paid.¹

§ 459. **Discretion of Directors to withhold Profits.** — The directors of a corporation have a discretionary power to withhold profits from the holders of common shares in order to accumulate a surplus and enlarge the company's business capacity; but it is the duty of the directors to pay the preferred shareholders their promised or guaranteed dividends, whenever the company has acquired funds which may rightfully be used for the payment of dividends. This rule applies with peculiar strictness where the preferred shareholders are entitled to receive their dividends annually out of profits earned during the current year only, and a deficit in any year does not become payable out of subsequent profits.²

Thus, in *Dent v. London Tramways Co.*,³ it was held that, after the property and capital of a tramway company had become impaired by using the entire earnings in order to pay

rather than shareholders. See, for example, *Williams v. Parker*, 136 Mass. 204. Compare *Phillips v. Eastern R. R. Co.*, 138 Mass. 122.

¹ *Boardman v. Lake Shore, &c. Ry. Co.*, 84 N. Y. 157; *Prouty v. Michigan Southern R. R. Co.*, 1 Hun, 655; *Lockhart v. Van Alstyne*, 31 Mich. 76, 84; *Taft v. Hartford, &c. R. R. Co.*, 8 R. I. 310, 333. Compare *Elkins v. Camden, &c. R. R. Co.*, 36 N. J. Eq. 233, 236. See also *Henry v. Great Northern Ry. Co.*, 4 K. & J. 1; s. c. 27 L. J. Ch. 1; s. c. 1 De G. & J. 606; *Webb v. Earle*, L. R. 20 Eq. 556; *Smith v. Cork, &c. Ry. Co., Ir. R.* 3 Eq. 356; 5 Eq. 65;

Crawford v. Northeastern Ry. Co., 3 K. & J. 723; *Corry v. Londonderry, &c. Ry. Co.*, 29 Beav. 263; *Coates v. Nottingham Water Works Co.*, 30 Beav. 86; *Matthews v. Great Northern Ry. Co.*, 28 L. J. Ch. 375; *Sturge v. Eastern Union Ry. Co.*, 7 De G., M. & G. 158; *Fielden v. Lancashire, &c. Ry. Co.*, 2 De G. & S. 531.

² *Nickals v. New York, &c. R. R. Co.*, 15 Fed. Rep. 575. Compare *St. John v. Erie Ry. Co.*, 22 Wall. 136; 10 Blatchf. 271.

³ *Dent v. London Tramways Co.*, L. R. 16 Ch. Div. 344. Compare *St. John v. Erie Ry. Co.*, 22 Wall. 136; 10 Blatchf. 271.

dividends to the common shareholders, instead of reserving part of the earnings for repairing its tramway and rolling stock, the deterioration thus caused could not be repaired, in subsequent years, by withholding the actual profits of those years from the preferred shareholders, whose dividends were payable in each year, out of the profits of that year only.

§ 460. But the fact that a corporation has made profits is not alone sufficient to show that it is able to pay dividends, or that it ought to pay its preferred shareholders. It is the right and the duty of the directors to keep on hand at all times a fund sufficient to meet current expenses, and to make reasonable provision against such accidents and losses as are incidental to the business in which the company is engaged. It is often a question involving the exercise of business knowledge and judgment, whether a corporation can safely use any portion of its profits in paying dividends. The power of deciding this question should not be taken from the directors and assumed by the courts, unless it is clear that the directors have a mistaken view of their legal duties, or have acted in bad faith.¹

§ 461. **Preference in Distribution of Capital.**— Ordinarily, preferred shareholders have no preference in the distribution of the company's capital, when the business is wound up. A right of this kind cannot be presumed from the fact that a preference has been given in the payment of dividends;² but under an express agreement, a preferred shareholder may be entitled to withdraw the amount of his shares before the other shareholders can take anything. The rights of the preferred member are thus assimilated in many respects to those of a creditor.³

¹ See *Culver v. Reno Real Estate Co.*, 33 N. J. Eq. 181; *In re London Co.*, 91 Pa. St. 367; *Barnard v. India Rubber Co.*, L. R. 5 Eq. 519; *Vermont, &c. R. R. Co.*, 7 Allen, Griffith v. Paget, L. R. 6 Ch. Div. 519; *Richardson v. Vermont, &c. R. R. Co.*, 44 Vt. 622; *Stevens v. South Devon Ry. Co.*, 9 Hare, 313, 326.

² *McGregor v. Home Insurance*

³ *In re Bangor, &c. Slate, &c. Co.*, L. R. 20 Eq. 59; *Warren v. King*, 108 U. S. 389; *McGregor v. Home Insurance Co.*, 33 N. J. Eq. 181; *Gordon's*

§ 462. **Remedies of Preferred Shareholders.** — If the directors of a corporation wrongfully refuse to declare the dividends due to preferred shareholders, any one of the latter is entitled to enforce his rights by bill in equity; an action at law is not the proper remedy.¹ The rights of preferred shareholders of a particular class are equal, and each is entitled to be paid *pari passu* with the others; it is evident, therefore, that a suit by a shareholder seeking to enforce his rights should be brought on behalf of all others similarly situated, and the relief granted in the suit should be for the benefit of all. It would be necessary, in a proceeding of this kind, to take an account of the earnings and expenses of the corporation in order to determine the amount of its profits. The corporation would clearly be a necessary defendant, and it seems that a demand made upon the directors before bringing suit should be alleged.

§ 463. **When the Right to issue Preferred Shares exists.** — It is clear that the right of issuing preferred shares cannot be implied, if the charter of the corporation does not authorize it to increase the amount of its capital by the issue of new shares of any kind. And even if the charter of a company expressly provides that its capital may be increased by the issue of new shares, it seems that this does not impliedly warrant the issue of shares conferring special privileges upon the holders. The issue of preferred shares does not merely increase the capital stock of the company; nor is it merely a means of raising money by pledge of the company's income. If the capital of a corporation is increased by the sale of new shares, the original members are entitled to share equally with the new members; and if money is borrowed upon

Exrs. v. Richmond, &c. R. R. Co., 78 Va. 501. Compare *In re London India Rubber Co.*, L. R. 5 Eq. 519. See *Burt v. Rattle*, 31 Ohio St. 116; *Totten v. Tison*, 54 Ga. 139; where the preferred shareholders appear to have been creditors in all except in name.

¹ *Richardson v. Vermont, &c.*

R. R. Co., 44 Vt. 613; *Williston v. Michigan Southern R. R. Co.*, 13 Allen, 400; *Boardman v. Lake Shore, &c. Ry. Co.*, 84 N. Y. 157, 180; *Dent v. London Tramways Co.*, L. R. 16 Ch. Div. 344. See further cases *supra*, § 280, and compare § 277.

security of the property or income of a corporation, the constitution of the company remains unchanged, and the security may be redeemed by repayment of the loan. But the issue of preferred shares permanently impairs the equality among the shareholders, and creates a perpetual charge upon the income of the company.¹ It may be said, also, that the issue of preferred shares is not a usual method of raising money, and that the power of creating preferences is a dangerous one to vest in the directors, or even the majority of the shareholders, as it might easily be made the source of unfairness and oppression.²

However, the authorities on this point are not in harmony. It has been claimed that the power to issue preferred shares would often be advantageous to all the shareholders, by enabling the company to raise funds without the risk of financial embarrassment and bankruptcy which would attend an ordinary absolute indebtedness; and it has been argued that, if the directors of a corporation may issue new shares,

¹ *Hutton v. Scarborough Cliff Hotel Co.*, 2 Dr. & Sm. 514, 521; affirmed, 13 W. R. 631; s. c. 12 L. T. N. s. 289; *In re Bangor, &c. Slate, &c. Co.*, L. R. 20 Eq. 59; *Moss v. Syers*, 32 L. J. Ch. 711; *Harrison v. Mexican Ry. Co.*, L. R. 19 Eq. 358.

In *Melhado v. Hamilton*, 28 L. T. N. s. 578, affirmed 29 L. T. N. s. 364, Vice-Chancellor Malins said: "It has always been considered, I think on the soundest principles, that preference shares cannot be created by a company unless there is an express power to create them."

In *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159, the charter of the company provided that "Said company shall have power . . . to issue certificates of stock representing the value of their property in such form and subject to such regulations as they may from time to time by their by-laws prescribe."

Shares were accordingly issued to the amount of ten millions of dollars. Afterwards the holders of a majority of the shares adopted a by-law providing that every shareholder should be entitled to exchange his shares for an equal number of preferred shares, upon paying the company a bonus of five dollars upon each share exchanged. The Court of Appeals of New York held that the action of the majority was unauthorized, and that the issue of the preferred shares in exchange for ordinary shares was not a legitimate means of raising money for the company's use.

There seems to be no objection, if the right to retire the preferred shares upon payment of the money advanced is reserved by the corporation. *West Chester, &c. R. R. Co. v. Jackson*, 77 Pa. St. 321.

² *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159.

and also incur debts, there is no reason why they may not, at the same time, issue new shares, and confer upon the holders a claim upon the company's profits, prior to that of existing shareholders but subsequent to that of creditors.¹

§ 464. The objections which have been raised against the existence of a right to issue preferred shares where no such right has been provided for in the charter or articles of association of the company, are all based upon the assumption that such issue would be in violation of the contract rights of the existing shareholders. If the existing shareholders unanimously give their consent to an issue of preferred shares, these objections would have no application.

It has been held on this ground, that, after an unauthorized issue of preferred shares has been acquiesced in and ratified by all the shareholders in the corporation, the latter cannot afterwards refuse to recognize the preferred shares as valid.²

There seems to be no reason for doubting that the issue of preferred shares may be provided for at the organization of a corporation under general laws, by inserting proper provisions in the articles of association, unless there be something in the laws prohibiting the issue of this class of shares. And it seems that an issue of preferred shares is valid in any case where the shares are properly classified at the outset, and all the shares in the company are subscribed for or taken subject to the terms of the classification.³

¹ See *Hazlehurst v. Savannah, &c. R. R. Co.*, 43 Ga. 15; *Totten v. Tison*, 54 Ga. 140; *Bates v. Androscoggin, &c. R. R. Co.*, 49 Me. 491; *Covington v. Covington, &c. Bridge Co.*, 10 Bush, 69; *Westchester, &c. R. R. Co. v. Jackson*, 77 Pa. St. 321.

In *Harrison v. Mexican Ry. Co.*, L. R. 19 Eq. 358, Sir George Jessel held that the issue of preferred shares was authorized by a clause in the articles of association of a company, authorizing an increase of its capital to be made by the issue of new shares

"in such manner, to such amount, and to be with and subject to such rules, regulations, privileges, and conditions, as the company in general meeting . . . shall think fit."

² *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159; *Lockhart v. Van Alstyne*, 31 Mich. 81; *Hazlehurst v. Savannah, &c. R. R. Co.*, 43 Ga. 53.

³ *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159, 178; *Harrison v. Mexican Ry. Co.*, L. R. 19 Eq. 358.

It has been held that authority to issue preferred shares may be conferred by an act of the legislature amending the charter of the corporation.¹ But this doctrine appears to be untenable. If the directors of a corporation or the majority of shareholders have no right to issue preferred shares because this would be in violation of the contract rights of the individual shareholders, the legislature would have no constitutional power to authorize the issue of such shares against the will of any shareholder.²

§ 465. **Construction of Grants of the "Income and Profits of Shares."**—Does not include undivided Earnings.—Shares are sometimes granted or bequeathed to pay the "income and profits" to one person for life or for years, with remainder over to another. The words "income and profits," when thus used, evidently do not mean the undivided profits earned by the corporation, but refer to dividends declared upon the shares. It is true that profits earned by a corporation *in reality* belong ultimately to the individual shareholders who form the corporation; but they are not "income and profits of the shareholders," according to the natural and ordinary use of those terms, until separated from the general corporate fund and divided among the shareholders.

A person holding shares for life or for a term of years would have no means of obtaining the benefit of profits earned by the corporation during the tenancy for life or for years, except by obtaining a distribution of the profits among the shareholders, or by selling the shares themselves and retaining the increase of their value. It is clear that the latter proceeding would not be warranted by a simple grant or bequest of the use, income, or profits of the shares, as such grant would imply the preservation of the shares themselves for the benefit of the remainderman. It is clear, also, that a person holding shares for life or for years cannot compel the corporation to declare a dividend and distribute the profits

¹ Rutland, &c. R. R. Co. v. Thrall, v. Proprietors, 8 Metc. (Mass.) 321; 35 Vt. 545; Covington v. Covington, and see *supra*, § 400.

&c. Bridge Co., 10 Bush, 69; Davis ² *Infra*, Chapter XV.

earned, if they are withheld by the directors in pursuance of the discretionary power conferred by the implied terms of the charter.¹ If the directors should exceed their discretionary power, and should refuse to declare a dividend when they ought to do so, any shareholder would have his remedy by a shareholders' bill in the usual form.²

§ 466. **All Regular Dividends are "Income or Profits" upon the Shares.** — It seems reasonable to hold that a grant of the "use, income, or profits" of shares for life or for a term of years, means a grant of all ordinary dividends declared by the company in the usual course of business during the tenancy for life or years, irrespective of the time when the money out of which the dividends are paid was earned, or the source from which it was obtained by the corporation. This would be the natural and ordinary meaning of the terms used. It has been held, accordingly, that ordinary dividends declared upon shares belong to the person to whom the "use, income, and profits" of the shares have been given for life, although the dividends are payable out of money earned before the life estate was created.³

Dividends declared by a corporation in the regular and usual course of its business belong to a tenant for life of shares, although payable out of the capital originally invested by the shareholders. In *Reed v. Head*,⁴ the dispute was as to the proper construction of a bequest of shares in a corporation, in trust to pay the income to a tenant for life, with remainder over. The business of the company was to improve certain land in which its capital had been invested, and afterwards to sell the land at a profit. It was held that dividends declared during the tenancy for life should be given to the tenant for life, although they were paid out of the proceeds of sales of the lands in which the company's capital was invested. The same rule would evidently be ap-

¹ *Supra*, § 447.

² *Supra*, § 276.

³ *Clive v. Clive*, Kay, 600; *Bates v. Mackinley*, 31 Beav. 281; *Barclay v. Wainwright*, 14 Vesey, 66. The rule above stated appears to be

assumed by all the authorities. See cases cited in the following sections.

⁴ *Reed v. Head*, 6 Allen, 174.

See also *Balch v. Hallet*, 10 Gray, 402; *Harvard College v. Amory*, 9 Pick. 446.

plicable to dividends declared by an ordinary mining company, or any other company of a similar character.¹

§ 467. **Unusual Dividends of Accumulated Earnings.** — After a corporation has allowed a large surplus of profits to accumulate, it is sometimes deemed advisable to distribute the accumulated fund among the shareholders in the form of a large dividend in cash, or to capitalize the surplus permanently by issuing a dividend in shares.² It is often difficult to determine whether a dividend of this description belongs to a grantee of the “use, income, and profits” of shares for life or a term of years, or to the person who is entitled to receive the shares in remainder. The question is one of definition, and no reasoning can be of any assistance in reaching the proper conclusion, unless by making clear the intentions of the grantor of the shares.

It seems reasonable to assume that a grant of the “income and profits” of shares for life is intended by the grantor to include all ordinary periodical dividends declared by the company during the existence of the life estate, whether payable out of profits earned during the life tenancy or not. But if a dividend is not an ordinary dividend, there would be no reason for assuming that the grantor intended it should go to the life tenant, unless it was in fact the income and profits of the shares according to the terms of the grant. If a grant or bequest merely provides that the “income and profits” of shares shall be paid to a tenant for life, it is reasonable to assume that the grantor or testator never specifically thought of extraordinary dividends. But the general intention of the grantor or testator in a case of this kind evidently is, that the shares shall be preserved for the benefit of the remainderman substantially in the condition in which they exist at the creation of the trust, and that the benefits accruing on the shares during the life tenancy shall belong to the life tenant. This intention cannot be carried out in all cases by distributing extraordinary dividends declared on the shares, without regard to the source out of which they are paid. Thus, a corporation desiring to restrict its oper-

¹ Compare *supra*, § 442.

² See *supra*, §§ 438, 452.

ations within narrower limits may properly distribute the surplus no longer needed in the business among its shareholders in the form of a dividend. A dividend of this description made during the life tenancy could certainly not be called income and profits of the shares during the life tenancy in any correct sense, if the surplus was earned before the life tenancy was created.¹ By distributing the accumulated surplus, the value of the shares would be correspondingly reduced.

So it is clear that the amount distributed by a corporation among its shareholders on winding up its business and making a final division of the corporate assets, is not in any sense "income and profits" on the shares. A tenant for life of shares, under these circumstances, would be entitled to receive only his share of the surplus profits accumulated since the tenancy for life began.²

So, if two corporations consolidate, and shares in the new company formed by consolidation are issued to take the place of the shares in the old companies, a bonus given to the shareholders of one of the old companies on account of the greater value of their shares would not belong to a person having the income of such shares for life, unless it consist of profits earned during the tenancy for life.³

On the other hand, if an unusual dividend is not only declared during the existence of a life estate in shares, but is also payable out of profits accumulated during the existence of the life estate, it would in every sense be "income and profits" accruing on the shares, and should be given to the life tenant, according to the terms of the grant.⁴

§ 468. **The Rule as to Stock Dividends.** — It has been held in various cases, that the rule applicable to dividends payable in cash does not apply to dividends payable in shares;

¹ Vinton's Appeal, 99 Pa. St. 434.

² Simpson v. Moore, 30 Barb. 637.

³ Clarkson v. Clarkson, 18 Barb. 646; Goldsmith v. Swift, 25 Hun,

201. If the bonus is in the form of an issue of extra shares, it should be applied as in case of a stock dividend. *Infra*, § 468.

⁴ See cases cited in the following sections.

that while the former may belong to the tenant for life, the latter should always be preserved as capital for the benefit of the remainderman.¹ However, the weight of reason and of authority appears to be the other way.

While the payment of a stock dividend is not an actual distribution of profits, it does materially affect the rights of the shareholders in respect of the accumulated profits. The effect of a stock dividend is to capitalize the accumulated profits permanently. The profits on account of which a stock dividend is declared can never afterwards be distributed among the shareholders as dividends, and, after the new shares have been issued, the right of the corporation to pay further dividends, and the right of the shareholders to demand them, must be considered with reference to the increased nominal capital.² The payment of a stock dividend is not merely an increase of the nominal amount of the shares, leaving the rights of the shareholders unchanged. In substance and effect, it amounts to a distribution of profits among the shareholders in cash, and a subsequent purchase of new shares in the company with the sums distributed.

Accordingly, in *Paris v. Paris*,³ Lord Eldon said: "As to the distinction between stock and money, that is too thin; and if the law is that this extraordinary profit, if given in the shape of stock, shall be considered capital, it must be capital if given as money."

It should be observed, however, that the distribution of a stock dividend permanently capitalizes only so much of the accumulated surplus as is applied in paying up the new shares. Any additional amount would be retained by the corporation as surplus, after the increase of its nominal capital, and might still be used to pay dividends. Hence, a tenant of shares for life is never entitled to receive more than

¹ See the Massachusetts cases 102-104; *Clarkson v. Clarkson*, 18 cited *infra*, § 472. See also *Re Barton's Trust*, L. R. 5 Eq. 238.

² *Supra*, § 453.

³ *Paris v. Paris*, 10 Vesey, 185. See also *Riggs v. Cragg*, 26 Hun, 89, 102-104; *Clarkson v. Clarkson*, 18 Barb. 646. In the last-named case, a gift of "the dividends" on stock was held to include all stock dividends. But see *contra*, *Re Barton's Trust*, L. R. 5 Eq. 238.

the par amount of a stock dividend, although the new shares are worth more than par, and the entire surplus of the company was earned during the existence of the life estate. He is entitled to receive only so much of the surplus earned during the life estate as is used in paying up the new shares.

§ 469. *The Authorities in Pennsylvania and New Jersey.*—Earp's Appeal¹ involved the construction of a bequest of the testator's residuary estate, upon trust to pay the "rents, income, and interest" to a beneficiary for life. The residuary estate included 540 shares in an iron manufacturing corporation. At the time of the testator's death, the company had accumulated a large surplus of profits, and the value of the shares had increased from \$50 to \$125 each. The company continued to accumulate large profits, and no dividend was declared for six years after the death of the testator. Then a stock dividend was declared, and the 540 shares held by the trustee were increased to 1350 shares in the enlarged capital. The court decided that the rule which rejects apportionments of periodical payments, or of ordinary dividends recurring at fixed intervals, had no application to a division of large accumulations extending over a number of years. It was therefore decreed that so much of the new issue of stock as was paid up out of profits earned since the death of the testator must be given to the tenant for life, and the rest kept for the remainderman.²

§ 469 *a*. This case should be compared with the decision of the same court in Moss's Appeal.³ The trustees under a will

¹ Earp's Appeal, 28 Pa. St. 368. See also Wiltbank's Appeal, 64 Pa. St. 256.

² The value of the 540 shares left by the testator, at \$125 each, was \$67,500. The value of the 1350 shares after the dividend was declared, at \$80 per share, was \$108,000. The difference between \$108,000 and \$67,500, being \$40,500, was represented by profits earned since the death of the testator, and

belonged to the tenant for life. The court therefore held that 506 of the new shares should be given to the tenant for life, and the remaining 296, together with the original 540 shares left by the testator, be retained upon the trusts declared by the will.

³ Moss's Appeal, 83 Pa. St. 264. See also Biddle's Appeal, 99 Pa. St. 278; *Brinley v. Grou*, 50 Conn. 66.

held certain shares in a corporation, to pay the "income, profits, and products" to the testator's wife for life. After the death of the testator, the company doubled the amount of its nominal capital, and gave to each of the existing shareholders the privilege of subscribing for as many shares as he already held, at par. The company had accumulated a very large surplus of profits, and the shares, before the new issue took place, were worth more than twice their par amount; the privilege of subscribing for the new shares at par was therefore of considerable value. The court held that no part of this privilege belonged to the life tenant, as income on the shares, but that it must be sold or exercised by the trustees so as to increase the principal of the trust estate.¹

The rule was stated by Chancellor Zabriskie in *Van Doren v. Olden*,² in the following words: "Where trust funds, of which the income, interest, or profits are given to one person for life, and the principal bequeathed over upon the death of the life tenant, are invested, either by the trustee or at the death of the testator, in stock or shares of an incorporated company, the value of which consists in part of an accumu-

¹ The trustees in Moss's case had sold the privilege attaching to part of the shares held by them, and used the proceeds of the sale to pay for the remainder of the shares which they were entitled to take.

There was certainly no actual distribution of profits in this case; nor was any portion of the accumulated profits permanently capitalized, as in case of the issue of a stock dividend. The new shares were paid up at par out of new funds, and the company's surplus remained as large after the new issue of shares as before. This surplus could at any time thereafter be distributed. See *supra*, § 438.

In *Wiltbank's Appeal*, 64 Pa. St. 256, the court held that a trustee holding shares upon a similar trust must exercise or sell a privilege of sub-

scribing for a new issue of shares at \$75 per share, for the sole benefit of the tenant for life. This decision was correct, provided the difference between the subscription price of the shares and their actual value, up to par, was made up by profits earned since the life estate began. The tenant for life was not entitled to have the benefit of profits earned by the corporation before the death of the testator, nor was he entitled to profits which were neither distributed nor permanently capitalized. If the profits exceeded the amount credited as payment on the shares, the surplus might at any time thereafter be distributed in the form of dividends.

² *Van Doren v. Olden*, 19 N. J. Eq. 177. To the same effect, see *Lord v. Brooks*, 52 N. H. 72.

lated surplus or undivided earnings laid up by the company, as is frequently the case, such additional value is part of the capital; this, as well as the par value of the shares, must be kept by the trustee intact, for the benefit of the remainderman, but the earnings of such capital, as well as upon the par value of the shares, belongs to the life tenant."

§ 470. *The Authorities in England and New York.*—In England it was formerly held, that, if stock is given to trustees to pay the use, income, and profits to a tenant for life, all extraordinary dividends must be preserved by the trustees, together with the shares, and given to the remainderman after the expiration of the life estate.¹ The later decisions are not all in harmony with this rule; but the courts do not appear in any case to have investigated whether the dividends were paid out of profits earned before or after the life tenancy began.²

In New York, the rule appears to be, that all dividends payable in money or in stock belong to the tenant for life of shares, under a bequest of "the use, income, and profits," whether the surplus on account of which the dividends are declared was earned before or after the life estate began.³ But a distribution of corporate funds which is not made in the form of a dividend does not go to the tenant for life, except to the extent of the profits added since the life estate began.⁴

§ 471. *The Rule in Massachusetts.*—In *Minot v. Paine*,⁵ the Supreme Court of Massachusetts held that a stock dividend on shares does not belong to the tenant for life, to

¹ *Brander v. Brander*, 4 Vesey, 634; *Clive v. Clive*, Kay, 600; *Plumbe* 800; *Paris v. Paris*, 10 Vesey, 185; *v. Neild*, 6 Jur. N. S. 529. *Re Barton's Trust*, L. R. 5 Eq. 238.
² Compare *Norris v. Harrison*, 2 Madd. 279; *Barclay v. Wainewright*, 14 Vesey, 66.

³ *Cuming v. Boswell*, 2 Jur. N. S. 1005; *Price v. Anderson*, 15 Sim. 473; *Johnson v. Johnson*, 15 Jur. 714; *Murray v. Glasse*, 17 Jur. 816; *Bates v. Mackinley*, 31 Beav. 281; *Hooper v. Rossiter*, 13 Price, 778; *Ward v. Combe*, 7 Sim.

⁴ *Woodruff's Estate*, Tucker, 58; *Goldsmith v. Swift*, 25 Hun, 201; *Riggs v. Cragg*, 26 Hun, 103; *Clarkson v. Clarkson*, 18 Barb. 646; *Simpson v. Moore*, 30 Barb. 637.

⁵ *Clarkson v. Clarkson*, 18 Barb. 646; *Simpson v. Moore*, 30 Barb. 637.

⁶ *Minot v. Paine*, 99 Mass. 101. See also *Richardson v. Richardson*, 75 Me. 571.

whom the net income of the shares was made payable, but must be preserved as part of the capital of the trust fund for the benefit of the remainderman. It was laid down as a rule, in this case, that cash dividends, however large, must be regarded as income upon shares, and stock dividends, however made, must be regarded as part of the capital.

In *Daland v. Williams*,¹ and subsequent cases, the same court held, that if a corporation declares a dividend payable in cash, and at the same time provides that this dividend shall be received in payment of new shares, to be issued and apportioned among the existing shareholders according to the number of shares already held by them, the dividend does not belong to a life tenant of the shares on which it was declared, whether received in cash or in shares, and that it is immaterial when the dividend was earned.

*Leland v. Hayden*² was a suit brought by the trustees of a fund, the income of which was payable to tenants for life, to ascertain the proper application of certain dividends declared upon shares constituting part of the trust fund. The corporation in which the shares were held had accumulated a large surplus since the death of the testator, and part of this surplus had been used to purchase shares of its own stock. The dividend was declared payable one half in shares which had been thus purchased and one half in cash, but with the privilege of taking, instead of cash, new shares issued by the company at par. The court held that the first half of the dividend belonged to the tenant for life as income on the shares, but that the latter half must be preserved as capital, whether received in cash or in shares.

It is difficult to follow the reasoning by which these conclusions and distinctions were reached. Reasoning based upon legal technicalities can clearly be of no service in ascertaining the intentions of a grantor. The rule in *Minot's* case undoubtedly has the merit of being simple and of easy application. But that does not prove it would carry out the

¹ *Daland v. Williams*, 101 Mass. 102 Mass. 542; *Atkins v. Albree*, 12 571; *Rand v. Hubbell*, 115 Mass. Allen, 359.

460. See also *Leland v. Hayden*, ² 102 Mass. 542.

intentions of the grantor of a trust of this kind. Indeed, it seems almost self-evident that a simple grant of the income of shares is not in fact intended as a grant of all cash dividends and of no stock dividends; and if the general purpose of a grant of this description is considered, it becomes evident that such a construction would in many cases defeat the intentions of the grantor rather than carry them out.

§ 472. **The Right of Shareholders to receive Certificates of Shares.**—It is customary to issue to each shareholder in a corporation a certificate stating the number of shares held by him, and other particulars indicating his rights as a shareholder in the company. The object of issuing these certificates is to provide the shareholders with evidence of their rights, and to enable them to deal with their shares freely by indorsement and transfer of the certificates. The certificates are treated as representing the shares themselves.¹

If the charter or by-laws of a corporation provide that certificates for shares shall be issued to the company's shareholders, the agents of the company are bound to issue a certificate in the customary form to each holder of shares upon the company's books. The same rule would apply in the absence of any express provision in the charter or by-laws, if the issue of certificates was an established practice of the company sanctioned by acquiescence of the shareholders. The agents of the company would have no right to discriminate against particular shareholders under these circumstances.

It has sometimes been supposed that a shareholder is not entitled to receive a certificate for his shares until the latter have been fully paid up;² but this appears to be a mistake.

If the charter or by-laws of a company provide that the "shareholders" shall receive certificates for their shares, it would seem that every shareholder would be entitled to a certificate indicating the number of shares held by him as

¹ See *supra*, §§ 185-192.

² Compare *Gould v. Town of Oneonta*, 71 N. Y. 298, 305; *Johnson v. Albany, &c. R. R. Co.*, 54

N. Y. 416. In these cases, however, it is evident that the dispute was as to the right to receive certificates for fully paid-up shares.

soon as he becomes a shareholder, or, in other words, as soon as his subscription is accepted and the company properly organized. A shareholder, undoubtedly, is not entitled to a certificate for *paid-up* shares until the shares have in fact been fully paid up;¹ he has merely a right to a certificate showing the number of shares which he holds, and the amount *actually paid* thereon, if anything has been paid. A person who has merely agreed to subscribe for shares, or to purchase them at a subsequent time, is clearly not entitled to a certificate, because he does not become a shareholder until the contract has been executed by making the subscription or purchasing the shares.²

§ 473. **The Right of Examining the Company's Books.** — The members of a simple copartnership are entitled to examine the partnership books and accounts whenever they desire;³ but this rule is inapplicable to large joint-stock companies and corporations. The control over the affairs of associations of this description is, by common consent, delegated to directors and managing agents, elected by the majority, and the individual shareholders have no authority or control except by their votes at shareholders' meetings. If every shareholder in a large joint-stock association were allowed to examine its books and accounts at pleasure, it would become impossible, in practice, to keep the books in a proper manner; moreover, it is evident that the result would be to lay open the affairs of the company to the public, and render any privacy in its dealings impossible.⁴ It is reasonable, how-

¹ In *Johnson v. Albany, &c. R. R. Co.*, 54 N. Y. 416, it was rightly held that a stockholder could not compel the corporation to issue to him a certificate for his shares until the full amount due upon them was paid to the company, although the latter was barred by the statute of limitations from maintaining a suit for the amount remaining unpaid.

² *Supra*, § 61.

³ *Stuart v. Lord Bute*, 12 Sim.

460; *Taylor v. Rundell*, 1 Phill. 222; *Freeman v. Fairlie*, 3 Mer. 43; *Toulmin v. Copland*, 2 Y. & C. Exch. 655.

⁴ In *Regina v. Mariquita, &c. Mining Co.*, 1 El. & El. 289, Lord Campbell, C. J., said: "The business of such companies could hardly be conducted if any one, by buying a share, might entitle himself at all times to gain a knowledge of every commercial transaction in which the directors engage, the moment that an

ever, that the majority of a company should have the power to examine its books and accounts, through agents appointed for that purpose at a meeting duly convened.¹

However, in the United States the prevailing doctrine appears to be that the individual shareholders in a corporation have the same right as the members of an ordinary partnership to examine their company's books, although they have no power to interfere with the company's management. The Supreme Court of Pennsylvania said: "Unless the charter provides otherwise, a shareholder in a trading corporation has the right to inspect its books and papers, and to take minutes from them, for a definite and proper purpose, at reasonable times. The doctrine of the law is, that the books and papers of the corporation, though of necessity kept in some one hand, are the common property of all the stockholders."²

In many instances statutes have been passed giving the shareholders of a corporation a right, subject to certain limitations, to obtain from the company's agents a sworn statement of its accounts, or to inspect its books in an orderly manner.³ A shareholder is clearly entitled to obtain a

entry of it is made on their books." Compare *Rex v. Merchant Tailors' Co.*, 2 B. & Ad. 115; *Rex v. Hostmen in Newcastle*, 2 Strange, 1223; *Mayor of Southampton v. Graves*, 8 T. R. 590.

¹ Such a right is given by the English Companies Act of 1862.

² *Commonwealth v. Phoenix Iron Co.*, 105 Pa. St. 111, 116; *Cockburn v. Union Bank*, 13 La. Ann. 289; *Deaderick v. Wilson*, 8 Baxter, 108, 137. See also *State v. Einstein*, 46 N. J. Law, 479; *Union Nat. Bank v. Hunt*, 76 Mo. 439; *Wannell v. Kem*, 57 Mo. 478; *People v. Northern Pacific R. R. Co.*, 50 N. Y. Super. Ct. 456.

³ For example, see the Act of New York of 1848, Chap. 40, §§ 25,

27, as amended by L. 1854, Chap. 201, and L. 1862, Chap. 472, § 1.

The Revised Statutes of New York provide that the transfer-books and books containing the names of the shareholders in a corporation shall be open to the examination of every shareholder in such company, during the usual hours of business, for thirty days previous to any election of directors. 1 R. S. 601, § 1 (Chap XVIII. Title IV. § 1). Under this provision see *Sage v. Lake Shore, &c. Ry. Co.*, 70 N. Y. 220; *Cotheal v. Brouwer*, 5 N. Y. 562; 10 Barb. 216.

In England the Companies Act of 1862 contains full provisions on this point. See also the Companies Clauses Consolidation Act (8 & 9

production of the company's books in a legal proceeding, whenever he can base his rights to an inspection upon the established rules of practice.¹

Vict., c. 16). 1 Lindley on Partnership, 811, 812.

It has been held in England, that a shareholder who, by the terms of the company's special act, is entitled at all reasonable times to inspect the books of the company, and who has applied for an inspection and has been refused, is not entitled to a mandamus against the company to allow an inspection, unless, before it was refused him, he stated for what purpose he desired to see the books, and unless such purpose

was, in the opinion of the court, a reasonable purpose, and unless the refusal proceeded from the managing body. 1 Lindley on Partnership (4th ed.), 809, citing *Rex v. Wilts, &c. Canal Co.*, 3 A. & E. 477; *Reg. v. Grand Canal Co.*, 1 Ir. Law R. 337; *Rex v. Clear*, 4 B. & C. 899.

¹ *Hall v. Connell*, 3 Y. & C. Exch. 707; *Birmingham, &c. Ry. Co. v. White*, 1 Q. B. 282; *Bank of Utica v. Hillard*, 5 Cowen, 419; *Williams v. Prince of Wales, &c. Ins. Co.*, 23 Beav. 338.

CHAPTER VII.

THE MANAGEMENT OF CORPORATIONS.

PART I.

THE POWERS OF THE MAJORITY.

§ 474. **The General Rule.** — As a corporation consists of the whole number of its members, it is apparent that it cannot carry on business directly and without the intervention of agents; for the unanimous action of the stockholders would be essential to every corporate act. It has, for this reason, been held to be an implied condition in the formation of every association of this character, that the majority of members present at a shareholder's meeting shall have authority to bind the whole association by their vote. The extent of the powers of the majority to act for the corporate body is measured by the charter itself: "Each and every shareholder contracts that the will of the majority shall govern in all matters coming within the limits of the act of incorporation."¹

The rule was laid down by Chief Justice Bigelow as follows: "It may be stated as an indisputable proposition, that every person who becomes a member of a corporation aggregate by purchasing and holding shares agrees, by necessary implication, that he will be bound by all acts and proceedings, within the scope of the powers and authority conferred by the charter, which shall be adopted or sanctioned by a vote of the majority of the corporation, duly taken and ascertained according to law. This is a result of the funda-

¹ *Per* Lindsay, J., in *Dudley* 578. See also *infra*, § 641 *et v. Kentucky High School*, 9 Bush, *seq.*

mental principle, that the majority of the stockholders can regulate and control the lawful exercise of the powers conferred on a corporation by its charter.”¹ It is implied that the majority shall have supreme authority to direct the policy of the corporation in attaining its chartered purposes, and shall have the power to appoint the usual managing agents, to whom the immediate control and direction of the company’s business is delegated.

§ 475. **Extent of Powers of the Majority.** — The powers of a majority to bind the whole company by their vote is derived solely from the agreement of association between the shareholders. The majority are not authorized to represent the company in any transaction which is not in pursuance of its chartered purposes;² nor are the majority empowered to do any act without complying with every formality which is prescribed by the company’s charter or articles of association, or by custom.³

Sometimes the general managing powers of a majority are restricted, with regard to special matters, by express provision of the charter; and, in certain cases, such restrictions may be implied. If the charter of a corporation provides that particular agents shall exercise certain powers, or do certain acts, the majority have no right to interfere with such agents in the exercise of the powers intrusted to them; and it is immaterial that such agents were appointed by the majority, and that the majority have authority to appoint their successors. Under these circumstances the majority can exercise merely an appointing power, and control the management of the company’s business by the election of such officers as will carry out their wishes.⁴

¹ *Durfee v. Old Colony, &c. R. R. Co.*, 5 Allen, 242; *Gifford v. New Jersey R. R. Co.*, 10 N. J. Eq. 174; *New Orleans, &c. R. R. Co. v. Harris*, 27 Miss. 537; *Treadwell v. Salisbury Manuf. Co.*, 7 Gray, 393; *Stevens v. South Devon Ry. Co.*, 9 Hare, 313.

² *Infra*, §§ 641-647.

³ See *infra*, § 477 *et seq.*

⁴ *Union Mutual Fire Ins. Co. v.*

Keyser, 32 N. H. 313; *Conro v. Port Henry Iron Co.*, 12 Barb. 27; *McCullough v. Moss*, 5 Denio, 567, 575; *Gashwiler v. Willis*, 33 Cal. 11; *Commonwealth v. Church of St. Mary’s*, 6 S. & R. 508; *State v. Curtis*, 9 Nev. 325. Compare *Aspinwall v. Meyer*, 2 Sandf. 186; *Howland v. Myer*, 3 N. Y. 290; and see cases *infra*, § 511.

§ 476. **Definition of "the Majority."** — "The majority of a corporation" means that portion of the shareholders present at a general meeting, who are entitled to control the corporation by their votes.

It is not necessary that a majority of all the shareholders in a corporation, or the holders of the greater part of its shares, be present at a meeting, in order that the resolutions of the meeting shall be binding on the corporation. In the absence of an express provision to the contrary, the rule is that such of the shareholders as actually assemble at a properly convened meeting constitute a quorum for the transaction of business, and a majority of that quorum have authority to represent the corporation.¹

Kent said: "There is a distinction taken between a corporate act to be done by a select and definite body, as by a board of directors, and one to be performed by the constituent members. In the latter case, a majority of those who appear may act; but in the former, a majority of the definite body must be present, and then a majority of the quorum may decide. This is the general rule on the subject; and if any corporation has a different modification of the expression of the binding will of the corporation, it arises from the special provisions of the act or charter of incorporation."²

§ 476 *a*. **Number of Votes of each Shareholder.** — It seems that, at common law, each shareholder is entitled to cast but

¹ *Field v. Field*, 9 Wend. 395; *Everett v. Smith*, 22 Minn. 53; *Madison Avenue Baptist Church v. Baptist Church, &c.*, 5 Roberts. 649; *Craig v. First Presbyterian Church*, 88 Pa. St. 42; *Brown v. Pacific Mail Steamship Co.*, 5 Blatchf. 525.

A majority of those actually voting at a meeting represent the company, and can elect officers. *Columbia Bottom Levee Co. v. Meier*, 39 Mo. 53. Compare *Commonwealth v. Wickersham*, 66 Pa. St. 134.

Where the consent of *two thirds of the qualified voters of a township* is,

by constitutional provision, made a condition precedent to the issue of township bonds, the bonds may be issued, provided two thirds of those actually voting give their consent. "All qualified voters who absent themselves from an election duly called are presumed to assent to the expressed will of the majority of those voting, unless the law providing for the election otherwise declares." *County of Cass v. Johnston*, 95 U. S. 360, 369. Compare *infra*, § 478.

² 2 Kent's Com. 293; and see *infra*, § 531.

one vote, irrespective of the number of shares which he holds;¹ but there are good reasons for holding that this rule has no application to ordinary joint-stock business corporations at the present day. The custom of giving the shareholders in such companies a vote for every share has become so well established, that it is fair to imply an intention to follow this custom in the absence of any indication to the contrary. It is generally provided by statute, or by express provision in the articles of association of a corporation, that the shareholders shall be entitled to a vote on account of each share.

The right of cumulative voting at the election of a board of directors, does not exist, unless conferred by express provision; each shareholder can cast but one vote on each share for each member of the board, whether he votes for one or all of them.²

§ 477. **Shareholders are not disqualified from voting by Reason of Personal Interest.** — The rule that the agents of a corporation have no authority to represent it in any transaction in which they are personally interested in obtaining an advantage at the expense of the company,³ has not been extended to the majority, who are authorized to bind the corporation by their vote at a general meeting of the shareholders. It is true that the majority derive their powers from an implied delegation of authority from the other shareholders, and are bound to use their powers in good faith, for the benefit of the whole association. But an investigation into the personal interests of the numerous shareholders voting at a general meeting would obviously be very difficult, if not impossible, and great uncertainty would result if the validity of acts of

¹ *Taylor v. Griswold*, 14 N. J. 82 Pa. St. 518; *Pierce v. Commonwealth*, 222, 237; *Commonwealth v. Conover*, 10 Phila. 55.

² In Pennsylvania, the system of cumulative voting at elections of the board of directors or managing officers of a corporation is established by provision of the Constitution. See *Hays v. Commonwealth*,

A shareholder is not bound to vote for the whole of a proposed board; he may vote for a part of the board, and elect these. *Vandenburgh v. Broadway Ry. Co.*, 29 Hun, 348.

³ *Infra*, § 517 *et seq.*

the majority were made to depend upon such an investigation. It has therefore been held, for reasons of convenience amounting to a practical necessity, that shareholders in a corporation are not disqualified from voting at a general meeting of the company by reason of their individual interests in the result of the vote. Even though a contract made by a shareholder to vote for or against a certain resolution or candidate for office be illegal, because contrary to public policy, the vote of such shareholder cannot be rejected.¹

But the courts would undoubtedly scrutinize with strictness any acts of the majority in which the majority were interested in obtaining an advantage at the expense of the corporation as a whole. If the majority attempt to appropriate the corporate funds to their own use, or in any manner to act unfairly towards the minority, or to depart from the company's charter, the courts would not hesitate to interfere at the suit of any aggrieved shareholder.² The majority may legally control the company's business, prescribe its general policy, make themselves the agents of the company, and take reasonable compensation for their services; but in taking control, they assume the duty of exercising diligence and of

¹ *East Pant Du, &c. Mining Co. v. Merryweather*, 2 H. & M. 254.

It cannot be laid down, as an inflexible rule, that an agreement made by a shareholder to vote for or against a certain measure or candidate is invalid. The validity of such an agreement would depend upon circumstances. Thus, a combination among shareholders to support a certain policy would not be illegal, if made in good faith for the purpose of advancing the company's interests; but an agreement made by a shareholder to sell his vote for an advantage to himself would be an agreement to misuse a power held in trust, and would therefore be condemned by the courts. See *Fisher v. Bush*, 35 Hun, 641; *Faulds*

v. Yates, 57 Ill. 416; *Foll's Appeal*, 91 Pa. St. 434; *Bolton v. Madden*, L. R. 9 Q. B. 55; *Elliott v. Richardson*, L. R. 5 C. P. 744; *Moffatt v. Farquharson*, 2 Bro. C. C. 338; *Card v. Hope*, 2 B. & C. 661.

² *Menier v. Hooper's Tel. Works*, L. R. 9 Ch. 350; *Barr v. New York, &c. R. R. Co.*, 96 N. Y. 444; *Currier v. New York, &c. R. R. Co.*, 35 Hun, 355; *Goodin v. Cincinnati, &c. Canal Co.*, 18 Ohio St. 169; *State v. Concord R. R. Co.*, 13 Am. & Eng. R. R. Cas. 94, 107; *Wright v. Oroville Mining Co.*, 40 Cal. 20, 27; *Ervin v. Oregon Ry., &c. Co.*, 20 Fed. Rep. 577; *Reilly v. Oglebay*, 25 W. Va. 36. See also *supra*, § 249; *infra*, § 529.

administering the company's affairs with the utmost good faith and fairness to the minority.¹

§ 478. **Shares belonging to the Corporation cannot be voted.** — It is only by the use of a fiction that a corporation can be considered a holder of shares in itself. When shares are purchased by the company which issued them, they really become extinguished, and no novation takes place; but the corporation may generally reissue new shares in place of those withdrawn.² It is clear, therefore, that shares purchased by a corporation cannot be voted upon. The same rule applies whether the shares be transferred directly to the company, or to a trustee for the company. Shares belonging to a corporation in reality belong to its shareholders collectively, whatever the form of ownership may be in legal phraseology. It would be an absurdity to allow shares belonging to the shareholders of a company collectively to be used for the purpose of controlling or diminishing their voice in the management of their own property.³

In New York, a manufacturing corporation, organized under the general laws, is prohibited from mortgaging its property except after obtaining and filing "the written assent of the stockholders owning at least two thirds of the capital stock." Under this provision, a corporation owning or controlling shares in itself cannot, by its agents, assent to the execution of a mortgage so as to make up the requisite assent of the owners of two thirds of its capital stock; nor can the shareholders actually assenting be deemed to represent a proportionate amount of the stock held in the name of the corporation.⁴

§ 479. **Meetings. — The Necessity of Notice.** — The majority are authorized to act for the corporation of which they con-

¹ Meeker v. Winthrop Iron Co., 17 Fed Rep. 48; and see *infra*, § 529.

² See *supra*, §§ 112-114.

³ Monsseaux v. Urquhart, 19 La. Ann. 482; Brewster v. Hartley, 37 Cal. 16; American Ry. Frog Co. v. Haven, 101 Mass. 398; *Ex parte*

Holmes, 5 Cow. 426; Vail v. Hamilton, 20 Hun, 355, 359. See Fraser v. Whalley, 2 H. & M. 10; Page v. Smith, 48 Vt. 266.

⁴ Vail v. Hamilton, 85 N. Y. 453. Compare Commonwealth v. Texas, &c. R. R. Co., 98 Pa. St. 90.

stitute a part only at a meeting called together in a proper manner. The object of requiring the majority to express their will by vote at a meeting is to enable all the shareholders to consult and deliberate together. Every shareholder is entitled to be present at such meeting, and to have a reasonable hearing.¹ For this reason, it is essential that all the shareholders be properly notified of a meeting before it is held. If notice to any one was omitted, those present at the meeting have no authority to act for the whole body of members, and the transactions at the meeting will not be binding as corporate acts. "It is not only a plain dictate of reason, but a general rule of law, that no power or function intrusted to a body consisting of a number of persons can be legally exercised without notice to all the members composing such body."²

But if the charter or by-laws of a company fix the time and place at which regular meetings shall be held, this is itself sufficient notice to all the shareholders, and no further notice is necessary.³

¹ See *Shortz v. Unangst*, 3 W. & S. 45, 52, 53; *Commonwealth v. Cullen*, 13 Pa. St. 133; *State v. Bonnell*, 35 Ohio St. 10; *People v. Albany, &c. R. R. Co.*, 55 Barb. 344; *Cannon v. Trask*, L. R. 20 Eq. 669; *MacDougall v. Gardiner*, L. R. 1 Ch. D. 14.

² *People v. Batchelor*, 22 N. Y. 134; *Rex v. Langhorn*, 4 A. & E. 538; *Moore v. Hammond*, 6 B. & C. 456; *Jackson v. Hampden*, 20 Me. 37; *McDaniels v. Flower Brook Manuf. Co.*, 22 Vt. 274; *San Buenaventura, &c. Manuf. Co. v. Vassault*, 50 Cal. 534; *People v. Albany, &c. R. R. Co.*, 55 Barb. 344; *Stockholders, &c. v. Louisville, &c. R. R. Co.*, 12 Bush, 62; *Smyth v. Darley*, 2 H. L. C. 789; *People's Mutual Ins. Co. v. Westcott*, 14 Gray, 440; *Wiggin v. First Freewill, &c. Church*, 8 Metc. (Mass.) 301. Compare *Stebbins v. Merritt*, 10 Cush. 27.

In *Stevens v. Eden Meeting House Society*, 12 Vt. 688, it was held that a warning by posting a written notice could not be proven by parol until the absence of the writing was accounted for.

Every reasonable presumption should be made in favor of the regularity of the meetings of a corporation aggregate; and the service of proper notice upon each shareholder will be implied, until the contrary appears. *Sargent v. Webster*, 13 Metc. (Mass.) 497; *McDaniels v. Flower Brook Manuf. Co.*, 22 Vt. 274. Compare *Lane v. Brainerd*, 30 Conn. 566, 577; *Pitts v. Temple*, 2 Mass. 538; *Copp v. Lamb*, 12 Me. 312.

* *People v. Batchelor*, 22 N. Y. 128; *San Buenaventura, &c. Manuf. Co. v. Vassault*, 50 Cal. 534; *Moore v. Hammond*, 6 B. & C. 456; *Warner v. Mower*, 11 Vt. 391; *State v. Bonnell*, 35 Ohio St. 10.

§ 480. **Who can call a Meeting.** — A meeting of shareholders is not binding upon the corporation unless it was called by some person having competent authority, or unless all the members entitled to vote are present.¹ If the charter and by-laws of a corporation, formed for business purposes, contain no express provision for the calling of meetings, the managing agents of the company have implied authority to call a meeting whenever they deem this to be advisable.² In most cases, however, the charter or by-laws of a company provide in express terms what officers or agents shall have authority to call meetings. Where the by-laws of a company provided that a proprietor's meeting should be called upon a petition "signed by twelve of them at least," it was held that a less number than twelve proprietors could not call a meeting, although they were the owners of more than twelve shares.³ And where it was provided in a by-law that meetings of the company should be called by the trustees, it was decided that the president had no authority to call a meeting.⁴ But a by-law providing that a meeting shall be called by the president upon application of a certain number of shareholders, does not preclude the directors from calling a meeting without such application.⁵

If the officers of a corporation wrongfully refuse to call a meeting, they may ordinarily be compelled to perform their duty by writ of mandamus.⁶

§ 481. **What Notice must be given.** — The notice of a meeting of the shareholders of a corporation must fix the exact time and place of the meeting, and, in certain cases, must also indicate the nature of the business to be transacted. If the manner of giving notice is prescribed by the char-

¹ *Bethany v. Sperry*, 10 Conn. 200; *Reilly v. Oglebay*, 25 W. Va. 36.

If a corporation has no officer by whom a meeting can be called together, it cannot carry on business until reorganized under a new charter. *Goulding v. Clark*, 34 N. H. 148.

² *Stebbins v. Merritt*, 10 Cush. 27.

³ *Evans v. Osgood*, 18 Me. 213.

⁴ *State v. Pettineli*, 10 Nev. 141.

⁵ *Citizens' Mutual Fire Ins. Co. v. Sortwell*, 8 Allen, 217. Compare *Chamberlain v. Painesville, &c. R. R. Co.*, 15 Ohio St. 225.

⁶ *Supra*, § 273.

ter, notice must be given in that manner in order to be effectual.¹

The time of meeting must be stated precisely;² if a meeting is called to order, and business is transacted before the time set, the proceedings will not be valid.³ If the time of meeting is prescribed by the charter or a by-law, that is sufficient notice; and it has been held that, if the time of meeting has been fixed by usage, or the tacit consent of the shareholders, no other notice is required.⁴

The meeting should be opened within a reasonable time after the hour indicated in the notice.⁵

The place of meeting must also be fixed. And if a meeting is held at a different place from that prescribed, it will not be valid.⁶

In case of an extraordinary or special meeting, the notice must indicate the nature of the business to be brought before the shareholders; but this is not necessary in case of a regular meeting for the transaction of ordinary business.⁷

The notice must be served upon each shareholder in person, unless otherwise provided by the charter or a by-law.⁸ And if the charter does not prescribe how long before a meeting notice must be served, a reasonable time is required.⁹

§ 482. **Regular and Special Meetings.**—A distinction has been made between regular and special meetings. The for-

¹ *Stockholders, &c. v. Louisville, &c. R. R. Co.*, 12 Bush, 62; *Johnston v. Jones*, 23 N. J. Eq. 216; *Stevens v. Eden Meeting House Society*, 12 Vt. 688; *Swansea Dock Co. v. Levien*, 20 L. J. Ex. 447.

² *San Buenaventura, &c. Manuf. Co. v. Vassault*, 50 Cal. 534.

³ *People v. Albany, &c. R. R. Co.*, 55 Barb. 344; *People v. Batchelor*, 22 N. Y. 134. Compare *Hardenburgh v. Farmers', &c. Bank*, 3 N. J. Eq. (2 Green) 68.

⁴ See *Atlantic, &c. Ins. Co. v. Sanders*, 36 N. H. 252; *Moore v. Hammond*, 6 B. & C. 456; *People v. Batchelor*, 22 N. Y. 128. Compare

Sampson v. Bowdoinham Steam Mill Co., 36 Me. 78.

⁵ *State v. Bonnell*, 35 Ohio St. 10; *South School District v. Blakeslee*, 13 Conn. 227.

⁶ *Miller v. English*, 21 N. J. Law, 317; *American Prim. Soc. v. Pilling*, 24 N. J. Law, 653. See *McDaniels v. Flower Brook Manuf. Co.*, 22 Vt. 274.

⁷ *Infra*, § 482.

⁸ *Stow v. Wyse*, 7 Conn. 214; *Stevens v. Eden Meeting House Soc.*, 12 Vt. 688; *Wiggin v. First Freewill, &c. Church*, 8 Metc. (Mass.) 301.

⁹ See *In re Long Island R. R. Co.*, 19 Wend. 37; *Wiggin v. First Freewill, &c. Church*, 8 Metc. (Mass.) 301.

mer are held regularly at stated times, according to the charter or by-laws of the company, while the latter are called at irregular or unusual times, at the option of the officer in whom the authority to call them is vested. A notice calling a special or extraordinary meeting must state particularly what the purpose of calling the meeting is; and no business can be transacted at the meeting except in relation to the matters specified.¹

It is unnecessary to notify the shareholders of the particular business to be brought before a regular meeting, unless it be of great importance, and of an extraordinary character.² In the latter case, the object of the meeting must be specified. Thus, where a meeting of a mutual fire insurance company was called "for the purpose of making such alterations in the by-laws of said company as may be deemed necessary, and for the transaction of such other business as may come before them," it was held that the notification was not sufficiently specific to enable a majority of those present at the meeting to increase the number of the directors of the company.³

§ 483. **The Right of Voting.**—The right to vote at the meetings of a corporation belongs only to its members or shareholders. An equitable assignment of shares does not effect a novation of the contract of membership, nor place the assignee in privity with the other shareholders, until a formal transfer has been executed in the manner required by the charter of the company. It has been held, accordingly, that the vendor of shares, and not the vendee, is entitled to vote upon them until a transfer has been recorded upon the

¹ *Re* Bridport Old Brewery Co., L. R. 2 Ch. 191; *Re* Silkstone Fall Colliery Co., L. R. 1 Ch. D. 38; *Atlantic De Laine Co. v. Mason*, 5 R. I. 463. See *Warner v. Mower*, 11 Vt. 385; *Savings Bank v. Davis*, 8 Conn. 192; *Merritt v. Farris*, 22 Ill. 303; *Zabriskie v. Cleveland, &c. R. R. Co.*, 23 How. 381, 394. Compare *Ehrenfeldt's Appeal*, 101 Pa. St. 186.

² *Sampson v. Bowdoinham Steam Mill Co.*, 36 Me. 78; *Warner v. Mower*, 11 Vt. 385.

³ *People's Mutual Ins. Co. v. Westcott*, 14 Gray, 440. See *People v. Batchelor*, 22 N. Y. 128; *South School District v. Blakeslee*, 13 Conn. 227. Compare *Wills v. Murray*, 19 L. J. Ex. 209.

stock-books;¹ and the same privilege belongs to a pledgor or mortgagor, unless a complete transfer was executed.² So a trustee³ or administrator⁴ is entitled to vote, so long as he is legally a shareholder in the company. A corporation or other collective body holding shares may vote upon them through a duly authorized agent.

It is important to observe that the legal right to vote belonging to the legal holder of shares may often be restricted by his equitable obligations to third persons. Thus, a shareholder who has made a complete sale or assignment of his interest in shares has no right, as against his assignee, to vote upon them without the consent of the assignee, although a regular transfer may not have been executed on the company's books.⁵

The right of a trustee to vote upon shares held in trust for other parties depends upon the terms of the trust. A shareholder may transfer his shares to nominees having no real ownership, for the purpose of enabling them to vote at the company's meetings, unless the charter or articles of association of the company restrict the right to vote to such persons as are the beneficial owners of their shares.⁶

¹ *McNeil v. Tenth Nat. Bank*, 46 N. Y. 332; *Monsseaux v. Urquhart*, 19 La. Ann. 482; *Johnston v. Jones*, 23 N. J. Eq. 228; *Downing v. Potts*, 3 Zab. 66; *In re Long Island R. R. Co.*, 19 Wend. 37; *State v. Pettineli*, 10 Nev. 141; *Becher v. Wells Flouring Mill Co.*, 1 McCra. 62. *Supra*, § 170.

In State v. Ferris, 42 Conn. 560, it was held that the right of a stockholder to vote upon shares standing in his name did not cease after an assignment in bankruptcy. But see *Re North Shore, &c. Ferry Co.*, 63 Barb. 556.

² *Hoppin v. Buffum*, 9 R. I. 513; *McHenry v. Jewett*, 26 Hun, 453; *Vail v. Hamilton*, 85 N. Y. 453; *In re Barker*, 6 Wend. 509; *Ex parte Willcocks*, 7 Cowen, 402; *McDan-*

iels v. Flower Brook Manuf. Co., 22 Vt. 274; *Scholfield v. Union Bank*, 2 Cranch, C. Ct. 115.

³ *Wilson v. Central Bridge Co.*, 9 R. I. 590; *In re Mohawk, &c. R. R. Co.*, 19 Wend. 135.

⁴ *In re North Shore, &c. Ferry Co.*, 63 Barb. 556.

⁵ See *supra*, §§ 175-180. *McHenry v. Jewett*, 26 Hun, 453.

In Vowell v. Thompson, 3 Cranch, C. Ct. 428, a mortgagee of shares was ordered by the Chancellor to execute a power of attorney or proxy to the mortgagor, in order to enable him to vote.

⁶ *In State v. Hunton*, 28 Vt. 595, it was held that a non-resident shareholder could not parcel out his shares among his friends so as to enable them to vote, as this would

If joint owners of shares disagree as to the votes to be cast by them, no vote can be received on account of these shares.¹

§ 484. **Powers of Inspectors at an Election.** — The right to appoint inspectors or judges of election, at a meeting of the shareholders for the election of directors, is vested in the shareholders themselves, and not in the board of directors.² Every person who is a legal holder of legally issued shares has a legal right, as against the other shareholders, to vote upon the shares; and neither the shareholders nor the inspectors at an election can inquire into the equitable ownership of the shares, or deprive the legal owner of his right to vote, by reason of obligations which he has assumed to other parties. In *Re St. Lawrence Steamboat Co.*,³ Depue, J., delivering the opinion of the court, said: "The general rule is, that the books of a corporation are the evidence of the persons who are entitled to the rights and privileges of stockholders in the management of the affairs of the corporation, with the single exception that stock really belonging to the corporation cannot, at any election for its directors, be voted upon directly or indirectly, the books of the corporation are the only evidence of who are the stockholders, and as such are entitled to vote at elections."

§ 485. **Illegal Votes. — Votes for disqualified Candidates.** — The reception of illegal votes does not necessarily vitiate the resolutions or acts of the majority. Thus, in order to set aside an election on account of the invalidity of votes cast, it must appear affirmatively that, if the illegal votes had not been counted, the successful ticket would not have received a majority.⁴ But a person having received a minority of

be in violation of a statute providing that no stockholder residing out of the State should be entitled to vote.

¹ *Re Pioneer Paper Co.*, 36 How. Pr. 111.

² *State v. Merchant*, 37 Ohio St. 251.

³ *Re St. Lawrence Steamboat Co.*, 44 N. J. Law, 529, 539, citing

Pender v. Lushington, L. R. 6 Ch. Div. 70; *Ex parte Willcocks*, 7 Cow. 402; *People v. Kip*, 4 Cow. 382, n.; *Re Barker*, 6 Wend. 509; *Re Wheeler*, 2 Abb. Pr. n. s. 361; *Re Cecil*, 36 How. Pr. 477; *Downing v. Potts*, 3 Zab. 66.

⁴ *First Parish v. Stearns*, 21 Pick. 148; *School District v. Gibbs*, 2 Cush. 39; *Christ Church v. Pope*,

votes at an election cannot be declared elected because a sufficient number of votes in his favor to make up a majority were refused.¹

It has been held that "Votes cast for a candidate who is disqualified for the office will not be thrown away, so as to make the election fall on a candidate having a minority of votes, unless the electors casting such votes had knowledge of the fact on which the disqualification of the candidate for whom they voted rested, and also knew that the latter was, for that reason, disabled by law from holding office."²

§ 486. **Voting by Proxy.**—The members of a corporation must vote personally, and cannot vote by proxy unless the right to vote by proxy is expressly conferred by the company's charter or by-laws.³ That the right of voting by proxy may be conferred through a by-law adopted by the majority, appears to be reasonably settled.⁴

No particular form of the delegation of authority to vote is necessary. The Supreme Court of New Jersey said: "A stockholder, who desires to exercise his right to vote on his stock by proxy, is undoubtedly bound to furnish his agent with such written evidence of the latter's right to act for him as will reasonably assure the inspectors that the agent is acting

8 Gray, 140; *Ex parte* Murphy, 7 Cow. 153; *In re* Chenango, &c. Ins. Co., 19 Wend. 635; *State v. Lehre*, 7 Rich. L. 234; *McNeely v. Woodruff*, 13 N. J. Law (1 Green), 352. Compare *Stewart v. Mahoney Mining Co.*, 54 Cal. 149.

¹ *People v. Phillips*, 1 Denio, 388; and see *Ex parte* Desdoity, 1 Wend. 98; *In re* Long Island R. R. Co., 19 Wend. 37; *State v. Swearingen*, 12 Ga. 23; *Monseaux v. Urquhart*, 19 La. Ann. 482; *Downing v. Potts*, 3 Zab. 66.

² *Re* St. Lawrence Steamboat Co., 44 N. J. Law, 529, 535, citing *Regina v. Coaks*, 3 E. & B. 249; *Regina v. Mayor of Tewkesbury*, L. R. 3 Q. B. 629; *Drinkwater v. Deakin*, L. R. 9 C. P. 626; *Etherington v. Wilson*,

L. R. 20 Eq. 606; *Re* Long Island R. R. Co., 19 Wend. 37; *Downing v. Potts*, 3 Zab. 66.

³ *Philips v. Wickham*, 1 Paige, 590, 598; *People v. Twaddell*, 18 Hun, 427; *Craig v. First Presbyterian Church*, 88 Pa. St. 42; *Commonwealth v. Bringham*, 103 Pa. St. 134; *Taylor v. Griswold*, 14 N. J. Law, 222; 2 Kent's Com. 294, 295. But see *Brown v. Commonwealth*, 3 Grant's Cas. 209; *State v. Tudor*, 5 Day, 329. Compare *Matter of Barker*, 6 Wend. 509.

⁴ *People v. Crossley*, 69 Ill. 195; *State v. Tudor*, 5 Day, 329; *Philips v. Wickham*, 1 Paige, 598. *Contra*, *Taylor v. Griswold*, 14 N. J. Law, 222, 228.

by the authority of his principal. But the power of attorney need not be in any prescribed form, nor be executed with any peculiar formality. It is sufficient that it appear on its face to confer the requisite authority, and that it be free from all reasonable grounds of suspicion of its genuineness and authenticity; and the court, in reviewing the proceedings at an election, must be satisfied that the inspectors had reasonable grounds for rejecting the proxy."¹

§ 487. **Formalities in conducting Meetings.** — The members of a corporation may adopt reasonable by-laws, regulating the manner of voting and of holding meetings, and directing the order of proceedings.² But such by-laws must not be in violation of any provision of the charter or general laws under which the corporation was formed; nor can the substantial rights of a shareholder be abridged thereby.³

The acts of a majority at a corporate meeting are not binding upon the company, unless the proceedings are conducted regularly and in accordance with general usage, or in the manner prescribed by the charter and by-laws of the company.⁴ But mere informalities will not be regarded, if the sense of the majority has been fairly expressed;⁵ and every reasonable

¹ *Re St. Lawrence Steamboat Co.*, 44 N. J. Law, 529, 534. See also *Re Cecil*, 36 How. Pr. 477; *Marie v. Garrison*, 13 Abb. N. C. 210.

The authority of a proxy may be revoked at any time, unless the delegation be irrevocable as between the parties. *Reed v. Bank of Newburgh*, 6 Paige, 337.

² *Juker v. Commonwealth*, 20 Pa. St. 484; *Commonwealth v. Woelper*, 3 S. & R. 29; *People v. Crossley*, 69 Ill. 195; *Kearney v. Andrews*, 10 N. J. Eq. 70; *In re Long Island R. R. Co.*, 19 Wend. 37; *Newling v. Francis*, 3 T. R. 189. Compare *Rex v. Spencer*, 3 Burr. 1827; *People v. Kip*, 4 Cow. 382, n.

³ *Taylor v. Griswold*, 14 N. J. Law (2 Green), 222; *Brewster v. Hartley*, 37 Cal. 24; *People v. Phillips*, 1

Denio, 388; *Commonwealth v. Gill*, 3 Whart. 228; *Petty v. Tooker*, 21 N. Y. 267; *Rex v. Head*, 4 Burr. 2515.

⁴ *State v. Pettineli*, 10 Nev. 141; *Johnston v. Jones*, 23 N. J. Eq. 216; *People v. Albany, &c. R. R. Co.*, 55 Barb. 344; *Commonwealth v. Woelper*, 3 S. & R. 29.

A person not a corporator may be elected moderator of a manufacturing corporation in Massachusetts. *Stebbins v. Merritt*, 10 Cush. 27.

⁵ *Philips v. Wickham*, 1 Paige, 590; *Downing v. Potts*, 3 Zab. 66; *People v. Albany, &c. R. R. Co.*, 55 Barb. 344; *Wheeler's Case*, 2 Abb. Pr. n. s. 361; *People v. Peck*, 11 Wend. 604; *People v. Campbell*, 2 Cal. 135; *Hardenburgh v. Farmers', &c. Bank*, 3 N. J. Eq. 68; *Hughes v. Parker*, 20 N. H. 58.

presumption will be made in favor of the regularity of the proceedings of a corporation and the election of its officers.¹

§ 488. **Place of holding Meetings.** — The meetings of the shareholders in a corporation cannot be held at an unreasonable hour; nor can they be called at an unusual place, where all the shareholders would be unable to be present without great inconvenience. It has for this reason been established as a rule, that shareholders' meetings must be held within the State by which the corporation was chartered, and that the majority at a meeting held in a foreign State have no authority to bind the corporation by their vote.² But there is no objection to a meeting held in a foreign jurisdiction, provided all the shareholders give their consent. And, in the absence of an express statutory prohibition, there appears to be no reason why the shareholders in an ordinary business corporation should not provide in their articles of association that meetings may be called at convenient places outside of the State under whose laws the company is formed.

§ 489. **Adjourned Meetings.** — After a meeting has been organized, it may be adjourned from time to time for the transaction of business, and no further notice to the shareholders is necessary. Redfield, J., said: "It is too well settled to require comment, that all corporations, whether municipal or private, may transact any business at an adjourned meeting which they could have done at the original meeting. It is but a continuation of the same meeting. Whether the meeting is continued without interruption for many days, or by adjournment from day to day, or from time to time, many days intervening, it is evident it must be considered the same meeting, without any loss or accumulation of powers."³

¹ *Blanchard v. Dow*, 32 Me. 557; *Bellows v. Todd*, 39 Iowa, 217, 218; *Ashtabula, &c. R. R. Co. v. Smith*, 15 Ohio St. 328; *Franco-Texan Land Co. v. Laigle*, 59 Tex. 339; *Ohio, &c. R. R. Co. v. McPherson*, 35 Mo. 13.

² *Ormsby v. Vermont Copper Mining Co.*, 56 N. Y. 623, 65 Barb. 363; *Mitchell v. Vermont Copper Mining Co.*, 40 N. Y. Super. Ct. 406; *Arms v. Conant*, 36 Vt. 745; *Miller v. Ewer*, 27 Me. 509; *Freeman v. Machias Water Power, &c. Co.*, 38 Me. 345;

The directors of a business corporation ordinarily have implied authority to hold their meetings wherever they find this to be most convenient. See *infra*, § 533.

³ *Warner v. Mower*, 11 Vt. 385,

§ 490. **Ratification of Informal Acts of the Majority.** — Acts of the majority, which are not binding upon the corporation because unauthorized by the charter, may be ratified by the other shareholders; and the want of previous authority to represent the whole company may thus be cured by unanimous consent.¹ This principle applies equally whether the acts of a majority are unauthorized because a departure from the company's business, or because formalities prescribed by the charter have not been observed.

Thus, if the members of a corporation are actually present at a meeting, it is immaterial that proper notice of the meeting was omitted.² And any irregularity in the proceedings of a meeting, or the act of a majority, will be cured by the acquiescence of those members who have a right to complain.³

§ 491. **The Power of making By-laws.** — It is implied in the charter of every private corporation formed for the pecuniary profit of its members, that the majority shall have power to make reasonable rules and regulations, or by-laws, for the better government of the company.⁴ The validity of by-laws prescribed by the majority depends upon the implied agreement of all the shareholders in forming the corporation, and therefore any by-law properly enacted by the majority is as binding upon the members of the company as a provision contained in the charter itself.⁵

The term "by-law" was originally applied to the laws and ordinances enacted by public or municipal corporations. The

391. See *Schoff v. Bloomfield*, 8 Vt. 472; *Farrar v. Perley*, 7 Me. 404; *Smith v. Law*, 21 N. Y. 296; *People v. Batchelor*, 22 N. Y. 128; *Wills v. Murray*, 4 Ex. 843; *Regina v. Grimshaw*, 10 Q. B. 747; *Scadding v. Lorant*, 3 H. L. C. 418.

¹ *Infra*, §§ 623-626.

² *Rex v. Chetwynd*, 7 B. & C. 695; *Re British Sugar, &c. Co.*, 3 K. & J. 408; *Jones v. Milton, &c. Turnpike Co.*, 7 Ind. 548; *People v. Peck*, 11 Wend. 604; *Stebbins v. Merritt*, 10 Cush. 27, 34.

³ *Rex v. Trevenen*, 2 B. & Ald. 339; *State v. Lehre*, 7 Rich. Law, 234; *Prettyman v. Supervisors*, 19 Ill. 406; *Musgrave v. Nevinson*, 2 Ld. Raym. 1358; *supra*, § 83.

⁴ *Supra*, § 325; *Child v. Hudson's Bay Co.*, 2 P. Wms. 207; *Martin v. Nashville Building Ass.*, 2 Coldw. 418.

⁵ *Cummings v. Webster*, 43 Me. 192, 197. Compare *McDermott v. Board of Police*, 5 Abb. Pr. 422; *Brick Presbyterian Church v. City of New York*, 5 Cowen, 538.

difference between a by-law of a private company and a law enacted by a municipality is wide and obvious. The former is merely a rule prescribed by the majority, under authority of the other members, for the regulation and management of their joint affairs. A by-law of a municipal corporation is a *local law*, enacted by public officers by virtue of legislative powers delegated to them by the State.

§ 492. **What By-laws are valid.** — The majority have implied authority to prescribe any by-law which is reasonable, and calculated to carry into effect the objects of the corporation in pursuance of its charter.¹ By-laws regulating the manner of holding meetings and electing officers,² and of transferring shares,³ are proper.

The majority may also make by-laws regulating the directors and other agents of the company in managing the corporate business;⁴ and they may provide that agents intrusted with the corporate funds shall provide security for the faithful performance of their duties.⁵

If the charter contains no provision to the contrary, the majority may prescribe how many directors shall constitute a quorum for the transaction of business, and the powers of the whole board may be exercised at any meeting at which such quorum are present.⁶

§ 493. **By-laws for the Management of a Corporation. — Expulsion of Members.** — The majority have a general authority to provide reasonable rules for the regulation of the corpora-

¹ *State v. Tudor*, 5 Day, 329; *Came v. Brigham*, 39 Me. 35; *People v. Sailors' Snug Harbor*, 54 Barb. 532; *Poultney v. Bachman*, 31 Hun, 49; *German, &c. Congregation v. Pressler*, 17 La. Ann. 128; *Harrington v. Workingmen's Benevolent Ass.*, 70 Ga. 340; *Security Loan Ass. v. Lake*, 69 Ala. 456.

² *Supra*, § 487.

³ *Supra*, §§ 164, 201.

⁴ Although one of the by-laws of a company provides that the directors shall have authority to amend

the by-laws, this does not authorize the directors to disregard or alter another by-law which was intended to impose a limitation on their powers. *Stevens v. Davison*, 18 Gratt. 819.

⁵ *Savings Bank v. Hunt*, 72 Mo. 597.

⁶ Compare *Hoyt v. Thompson*, 19 N. Y. 207, 215. The by-law in this instance appears to have been made by the directors, who were invested by the charter with full powers of management.

tors in carrying out their mutual agreement. Thus, a by-law of a chamber of commerce, providing for the expulsion of a member for non-compliance with a contract entered into with another member, was held valid, although the contract was not enforceable by suit at law on account of the Statute of Frauds.¹ Clubs, benevolent societies, stock and commercial exchange associations, and other similar bodies, usually provide by-laws for the trial and expulsion of members who have violated obligations imposed upon them by virtue of their membership, or who have become unfit to continue in their association. By-laws of this description have often been sustained;² but before a member can be expelled, he must always be given an opportunity of defending himself from the charges preferred against him.³

§ 494. **What By-laws are unauthorized.**—The charter of a corporation is its fundamental law; it designates the main objects for which the company was formed, and determines the rights and liabilities of its several members. By-laws which are calculated to assist in carrying into effect the purposes of the company are valid, but every by-law which is contrary to the charter, either in its special provisions or its main purposes, is unauthorized and void.⁴

¹ *Dickenson v. Chamber of Commerce*, 29 Wis. 45; *People v. New York Commercial Ass.*, 18 Abb. Pr. 271-279. By-laws of a similar character have been held valid in the following cases: *State v. Milwaukee Chamber of Commerce*, 47 Wis. 670; *Goddard v. Merchants' Exchange*, 9 Mo. App. 290; 78 Mo. 609.

² *Hussey v. Gallagher*, 61 Ga. 86; *People v. Board of Trade*, 80 Ill. 134; *Leech v. Harris*, 2 Brewster (Pa.), 571; *Moxey v. Philadelphia Stock Exchange*, 37 Leg. Int. 82; s. c. 9 W. N. C. 441; *Dawkins v. Antrobus*, L. R. 17 Ch. Div. 615. Compare *State v. Williams*, 75 N. Car. 134.

³ *State v. Milwaukee Chamber of*

Commerce, 47 Wis. 670; *White v. Brownell*, 4 Abb. Pr. n. s. 162, 193; s. c. 2 Daly, 329; *Powell v. Abbott*, 9 W. N. C. 231; *Sibley v. Carteret Club*, 40 N. J. Law, 295; *Labouchere v. Earl of Wharnccliffe*, L. R. 13 Ch. Div. 346; *Fisher v. Keane*, L. R. 11 Ch. Div. 353. Compare *People v. Board of Trade*, 80 Ill. 134.

⁴ *Bergman v. St. Paul, &c. Building Ass.*, 29 Minn. 275, 282; *Martin v. Nashville Building Ass.*, 2 Coldw. 418; *Child v. Hudson's Bay Co.*, 2 P. Wms. 207, 209; *State v. Curtis*, 9 Nev. 325; *Rex v. Cutbush*, 4 Burr. 2204; *Calder, &c. Nav. Co. v. Pilling*, 14 M. & W. 76; *Adley v. Whitestable Co.*, 17 Ves. 315; 19 Id. 304.

It is evident that a by-law in violation of the common law or statute law is not within the implied powers of the majority. And it is equally clear that a majority of the members of a company, acting under authority delegated to them by the other members, cannot enlarge the legal powers of the whole company. Thus, the majority cannot by means of a by-law authorize a corporation to make a usurious contract.¹

Upon a similar principle, it has been held that a national bank, organized under the act of Congress of 1864, cannot by means of a by-law or a provision in its articles of association acquire a lien on the shares of its shareholders for debts due by them. This would be contrary to the provision in the banking act, that no association formed under it "shall make any loan or discount on the security of shares of its own stock, nor be the purchaser of any such shares."²

§ 495. *By-laws in Restraint of Trade or the Right of Suit.* — The majority of a corporation can exercise no greater powers than the individual members of the company can bestow. Therefore, a by-law in restraint of trade is void;³ even an express contract will not be enforced, if an undue restriction of the liberty of trade. A by-law prohibiting the members of a corporation from suing is also necessarily void; for even an express agreement not to sue does not oust the jurisdiction of the courts.⁴ Thus, it was held by the Supreme Court of Massachusetts that a by-law providing that the members of a mutual insurance company should bring suit in a certain county, in case their claims were disallowed by the directors, was void; but a by-law limiting the time in which suit must be brought will be given effect.⁵

¹ *Seneca County Bank v. Lamb*, 26 Barb. 595. *Ritterband v. Baggett*, 42 N. Y. Super. Ct. 556. Compare *Adley v.*

² *Bank v. Lanier*, 11 Wall. 369; *Whitestable Co.*, 17 Ves. 316; *Rex Bullard v. Bank*, 18 Wall. 589. *v. Tappenden*, 3 East, 186.

Supra, §§ 201, 384.
³ *Sayre v. Louisville, &c. Ass.*, 1 Duv. 144; *Rex v. Coopers' Co.*, 7 T. R. 543; *Gunmakers', &c. Soc. v. Fell*, Willes R. 384. See also *People v. Medical Soc.*, 24 Barb. 570; *Moore v. Bank of Commerce*, 52 Mo. 377;

⁴ See *infra*, § 971, note.

⁵ *Nute v. Hamilton Mut. Ins. Co.*, 6 Gray, 174; *Amesbury v. Bowditch Mut. Ins. Co.*, 6 Gray, 596. See also *State v. Union Merchants' Exchange*, 2 Mo. App. 96; and compare *Anacosta Tribe v. Murbach*, 13 Md. 91.

§ 496. **Other invalid By-laws.** — The majority of a corporation have no power to alter the rights and liabilities of the shareholders, as fixed by the charter under which they united.¹ Thus, the majority cannot, through a by-law, impose upon the shareholders a liability to pay assessments;² nor can the right of a shareholder to vote at corporate meetings be taken away or restricted.³ It is clear that a by-law having the effect of an *ex post facto* law, or impairing the vested rights of any shareholder, is unauthorized.⁴

In *Kent v. Quicksilver Mining Co.*,⁵ Folger, J., said: "All by-laws must be reasonable, and consistent with the general principles of the law of the land, which are to be determined by the courts when a case is properly before them. A by-law may regulate or modify the constitution of a corporation, but cannot alter it. The alteration of a by-law is but the making of another upon the same matter. If the first must be reasonable and in accord with the principles of law, so must that which alters it. If, then, the power is reserved to alter, amend, or repeal, and that reservation enters into a contract, the power reserved is to pass reasonable by-laws agreeable to law. But a by-law that will disturb a vested right is not such; and it differs not when the power to make and alter by-laws is expressly given to a majority of the stockholders, and the obnoxious ordinance is passed in due form."

This right to make by-laws rests entirely upon the implied agreement of the shareholders in forming the company. By-laws which are vexatious, unequal, oppressive, or manifestly detrimental to the interests of the corporation, are therefore unauthorized and void.⁶ It has been held that the majority

¹ *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159.

² *Kennebec, &c. R. R. Co. v. Kendall*, 31 Me. 470; *Free Schools, &c. v. Flint*, 13 Metc. (Mass.) 539.

³ *Brewster v. Hartley*, 37 Cal. 24; *Rex v. Spencer*, 3 Burr. 1827; *People v. Kip*, 4 Cowen, 382, n.

⁴ *People v. Fire Department*, 31

Mich. 458; *People v. Crockett*, 9 Cal. 112; *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159, 178.

⁵ *Kent v. Quicksilver Mining Co.*, 78 N. Y. 182, 183.

⁶ *Cartan v. Father Matthew, &c. Soc.*, 3 Daly, 20; *People v. Medical Soc.*, 24 Barb. 570; *Scriveners' Soc. v. Brooking*, 3 Q. B. 95; *Carter v.*

have no authority to pass a by-law that any shareholder failing to pay an assessment shall forfeit his shares, or the dividends accruing upon them, until all arrears have been paid.¹ And so a by-law of a merchants' exchange company, requiring its members to submit their controversies to arbitration on pain of expulsion if they bring suit, has been held to be invalid.²

§ 497. **Construction of By-laws.**—It is a question for the court to decide whether or not a by-law is within the powers delegated to the majority by the express or implied terms of the company's charter.³

By-laws should be construed liberally, and in accordance with the construction placed upon them by the company itself.⁴ If a by-law consists of distinct parts separable from each other, and one part is unauthorized, while the other is within the powers of a majority, the valid part will stand.⁵

§ 498. **Form of Adoption of By-laws.**—By-laws may be adopted by a corporation without the use of the corporate seal, and no entry in writing is necessary. The existence of by-laws may be established by custom, or by the acquiescence of those authorized to enact them.⁶ But if an entry in writing authenticated by the corporate seal, or any other formality, is prescribed by the charter or another by-law, the majority have no right to act without observing the prescribed forms.⁷

Sanderson, 5 Bing. 79; Calder, &c. Nav. Co. v. Pilling, 14 M. & W. 76.

¹ *Adley v. Reeves*, 2 M. & S. 53; *Cartan v. Father Matthew, &c. Soc.*, 3 Daly, 20. Compare *Pentz v. Citizens' Fire Ins., &c. Co.*, 35 Md. 73; *Kirk v. Nowill*, 1 T. R. 118.

² *State v. Union Merchants' Exchange Co.*, 2 Mo. App. 96. Compare *Anacosta Tribe v. Murbach*, 13 Md. 91.

³ *State v. Overton*, 24 N. J. Law, 440; *Commonwealth v. Worcester*, 3 Pick. 462.

⁴ *Re Dunkerson*, 4 Biss. 227; *State v. Conklin*, 34 Wis. 21; *Vintners' Co. v. Passey*, 1 Burr. 235, 239;

Poulterers' Co. v. Phillips, 6 Bing. N. C. 314. See *Rex v. Bailiffs, &c. of Eyè*, 4 B. & Ald. 271; *Breneman v. Franklin, &c. Ass.*, 3 W. & S. 218.

⁵ *Amesbury v. Bowditch Mut. Ins. Co.*, 6 Gray, 596; *State v. Curtis*, 9 Nev. 337; *Rogers v. Jones*, 1 Wend. 237; *Cleve v. Financial Co.*, L. R. 16 Eq. 363.

⁶ *Union Bank v. Ridgely*, 1 H. & G. 324, 413; *State v. Curtis*, 9 Nev. 335. See *Henry v. Jackson*, 37 Vt. 431; *Bank of Holly Springs v. Pinson*, 58 Miss. 421.

⁷ *Dunston v. Imperial Gas Light, &c. Co.*, 3 B. & Ad. 125.

§ 499. **Repeal of By-laws.** — A by-law passed by the majority at a shareholders' meeting, or by the board of directors under authority conferred by the charter, is the act of the whole association, and can be abrogated only in pursuance of authority conferred by the whole association. Neither the majority of the shareholders nor the board of directors have a right to disregard a by-law which was properly passed; a by-law can be repealed only in the manner prescribed by the charter in express or implied terms.¹

It is generally implied that by-laws may be repealed by vote of the same authority which made them,² and a repeal may be presumed from general non-observance.³ But it is clear that the majority cannot impair vested rights by repealing a by-law upon which the shareholders have relied and acted.⁴

§ 500. **The Effect of By-laws.** — Upon whom they are binding. — Every shareholder is bound by the by-laws adopted by the majority on behalf of the corporation, under authority of the charter.⁵ But a person who is not a member of the company is not bound; nor can he claim any rights by the force of the adoption of a mere by-law; the majority, in enacting a by-law, act on behalf of the shareholders only.⁶ Thus, a creditor of a corporation cannot hold the shareholders individually liable for its debts, although a by-law declaring them liable was passed with their consent, unless credit was given in consideration of the assumption of individual liability by the shareholders. The Supreme Court of Massachusetts said: "The office of a by-law is to regulate the conduct and define the duties of the members towards the corporation

¹ Compare, however, *Martino v. Commerce Fire Ins. Co.*, 47 N. Y. Super. Ct. 520.

² *Smith v. Nelson*, 18 Vt. 511, 550; *Rex v. Ashwell*, 12 East, 22.

A corporate resolution which can be taken only by a two-thirds vote, cannot be rescinded by a bare majority. *Stockdale v. School District of Wayland*, 47 Mich. 226.

³ *Atty.-Gen. v. Middleton*, 2 Ves. Sen. 327.

⁴ *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159.

⁵ *Susquehanna Ins. Co. v. Perine*, 7 W. & S. 348; *German, &c. Congregation v. Pressler*, 17 La. Ann. 128; *Palmyra v. Morton*, 25 Mo. 593; *Cummings v. Webster*, 43 Me. 192.

⁶ As to municipal corporations, see *supra*, § 491.

and between themselves. So far as its provisions are in the nature of contract, the parties thereto are the members of the association between themselves; or the corporation on the one side, and its individual members on the other. The right of any third party, stranger to the association, to establish a legal claim through such a by-law, must depend upon the general principles applicable to express contracts.”¹

So a by-law of a savings bank prescribing the manner of investing savings deposits is merely a direction to the officers of the bank, and confers no rights upon the depositors unless it is made the basis of a contract with them.²

§ 500 a. **Whether Shareholders and Directors are deemed to have Notice of By-laws.** — It has sometimes been stated as a rule of law, that the shareholders and managing agents of a corporation must be deemed to have notice of the company’s by-laws; but this statement is not accurate. Shareholders are undoubtedly bound, in all matters relating to their rights and obligations *as shareholders*, by every by-law duly adopted by the majority pursuant to the charter. This, however, results from the implied terms of their agreement of membership, and not from a supposed notice of the by-law; — it is immaterial whether they have notice of the by-law or not. So the agents of a corporation are usually bound by the company’s by-laws in all matters relating to their agency, irrespective of notice of the by-laws. Moreover, it is often fair to presume that the shareholders and agents of a corporation have notice of its by-laws, without direct proof of notice.

However, the presumption of notice arises only if it is reasonable to infer notice in view of the established facts of the case. If the fact of notice is material, it must be proven against shareholders and agents as well as against strangers, by direct or by presumptive evidence, and cannot be imputed by an arbitrary rule of law.³

¹ Flint v. Pierce, 99 Mass. 68, 70. Touche v. Metropolitan Ry., &c. Co., L. R. 6 Ch. 671.
 See also Mellen v. Whipple, 1 Gray, 317; Field v. Crawford, 6 Gray, 116; ² Ward v. Johnson, 95 Ill. 216.
 Dow v. Clark, 7 Gray, 198; Eley v. ³ Rice v. Peninsular Club, 52 Mich. Positive, &c. Life Ass. Co., L. R. 87; Baker v. Woolston, 27 Kans. 185;
 1 Exch. Div. 20, 88. Compare First Nat. Bank v. Drake, 29 Kans.

§ 501. **Rules and Regulations published by Companies.**—Companies which are engaged in enterprises of a public character frequently adopt and publish rules for the government of those who enter into transactions with them. These rules or regulations are sometimes called by-laws, but are obviously different from the ordinary by-laws passed by private corporations for the regulation of their own management. By-laws of the latter class are binding upon the members of a corporation by virtue of the implied terms of their contract; those of the former class are merely terms or conditions made binding upon all persons who choose to deal with the corporation.

Thus, railroad companies and other common carriers usually provide a series of rules and regulations for the safety and convenience of travellers and shippers and the direction of the company's subordinate employees. Persons dealing with such companies, with notice of reasonable rules and regulations so published, must be held to give their assent thereto, and to deal with the company upon the conditions offered.¹

A similar doctrine applies to the rules adopted by savings banks, prescribing the rights of depositors and the methods by which they may withdraw their funds; every depositor

311; *Tarbox v. Gorman*, 31 Minn. 62; *Union Nat. Bank v. Hunt*, 76 Mo. 439; *Wannell v. Kem*, 57 Mo. 478. Compare *Jones v. Arkansas, &c. Agricultural Co.*, 38 Ark. 17; *Bank of Wilmington, &c. v. Wollaston*, 3 Harr. (Del.) 90; *Chaffee v. Rutland R. R. Co.*, 55 Vt. 110.

¹ In *State v. Overton*, 24 N. J. Law, 440, Chief Justice Green said: "The *by-laws* of a private corporation bind the *members only* by virtue of their assent, and do not affect third persons. All regulations of a company affecting its business, which do not operate upon third persons, are properly denominated by-laws of the company, and may come within the

operation of the principle. Within this limit, it is the peculiar and exclusive office of the court to decide upon the validity of the regulation. But there is another class of regulations, made by corporations as well as by individuals, who are common carriers of passengers, which operate upon and affect the rights of others, which are not, properly speaking, by-laws of the corporation, and which do not fall within the operation of this principle. Of this character are all regulations touching the comfort and convenience of travellers, or prescribing rules for their conduct to secure the just rights of the company."

must be held to give his assent to these rules, and they form part of his contract with the company.¹

It should be observed, that depositors in a savings bank and members of a mutual insurance company in some instances occupy a position which is similar to that of the shareholders in an ordinary joint-stock corporation. A rule adopted by a savings bank, or a mutual insurance company, may therefore be binding upon its depositors or members, upon the principle which renders a by-law of a joint-stock company binding upon its shareholders, and in this case the rule is binding upon a depositor or member without actual notice.

§ 502. *Effect of Violation of By-laws by Agents.*—The powers of the agents of a corporation are often limited by the company's by-laws. Any act performed by an agent in violation of a by-law is necessarily in excess of the agent's authority, and is not binding upon the corporation unless some principle of estoppel be applicable.²

But a person dealing with an agent of a corporation is not bound, at his peril, to take notice of the company's by-laws, nor is notice of the by-laws presumed;³ and therefore, if a contract is entered into in good faith with an agent of a corporation acting within the scope of his apparent powers, the corporation will be bound, although the agent acted in violation of an existing by-law.⁴

For a similar reason, it follows that a corporation cannot enforce a by-law giving it a lien upon the shares of its members for debts due the company, as against a *bona fide* purchaser of certificates for shares who had no notice of the by-law.⁵

¹ See *Burrill v. Dollar Savings Bank*, 92 Pa. St. 134; *People's Savings Bank v. Cupps*, 91 Pa. St. 315; *Supreme Commandery v. Ainsworth*, 71 Ala. 436.

It has been held that a depositor who could not read, and for that reason failed to obtain actual knowledge of a published rule of the company, was nevertheless bound. *Burrill v. Dollar Savings Bank*, 92 Pa. St. 134.

² *Susquehanna Ins. Co. v. Perrine*, 7 W. & S. 348.

³ As to who is bound to take notice of by-laws, see *infra*, §§ 593–596.

⁴ *Samuel v. Holladay*, 1 Woolw. 400; s. c. *McCahon*, 214; *Mechanics', &c. Bank v. Smith*, 19 Johns. 115. Compare *Susquehanna Ins. Co. v. Perrine*, 7 W. & S. 348; *Worcester v. Essex, &c. Bridge Co.*, 7 Gray, 457; *infra*, §§ 593–595.

⁵ *Driscoll v. West Bradley, &c. Manuf. Co.*, 59 N. Y. 109; *supra*, § 203.

PART II.

THE EXTENT OF THE POWERS OF THE AGENTS OF A CORPORATION.

§ 503. **The Appointment of Agents.**—It would be a departure from the plan of this treatise to enter into a general discussion of the principles of the law of agency. The principles of the law of agency apply to corporations with the same force as to mere individuals. The application of the principles of the law of agency to corporations will be discussed somewhat in detail in a subsequent chapter.¹ In this connection it is proposed to consider only the extent of the authority delegated to the various agents of a corporation, so far as this depends upon the charter or articles of association of the company.

Charters of incorporation generally provide expressly that the affairs of the companies formed under them shall be managed by certain specified agents, having definite powers and duties. In the absence of express provisions of this character, it is a reasonable implication that the corporate affairs shall be managed in the customary manner.²

The individual shareholders of a corporation aggregate have no implied authority to represent the company for any purpose, or to interfere with the management of its business

¹ *Infra*, §§ 577-647.

² In *Protection Life Ins. Co. v. Foote*, 79 Ill. 361, 368, Justice Scholfield, delivering the opinion of the court, said: "It is as indispensable that mutual companies, as others, shall transact their business through officers and agents, and in the absence of express provisions in their charters limiting their appointment, or the scope of their powers and duties, it must be presumed that each person, in becoming a member

of the company, impliedly consents that it shall be represented by such officers and agents as are reasonably necessary for the transaction of its business, and that they shall possess the powers and perform the duties ordinarily possessed and performed by such officers and agents." Authority to appoint a board of directors by vote of the majority may be implied. *Hurlbut v. Marshall*, 62 Wis. 590.

in any respect. But it is implied that the majority present at a regularly called shareholders' meeting shall exercise a general supervisory power over the corporate affairs, and shall have authority to appoint the board of directors, or other agents who have the active management of the company's business in their charge.¹

§ 504. **How Agents may be appointed.** — The agents of a corporation may be appointed in the same manner as the agents of an individual; no formalities are required, nor is the use of the corporate seal necessary, unless the contrary be expressly provided by the company's charter.²

The appointment of an agent does not go into effect until it has been accepted by the appointee;³ but acceptance may ordinarily be presumed from the exercise of the power conferred, or from silent acquiescence with knowledge of the resolution of appointment.⁴

If a person is allowed to act as agent for a corporation with the knowledge and acquiescence of the superior agent or authority who would have authority to appoint him, the corporation will be bound by such acquiescence, and cannot repudiate the agency.⁵

§ 505. **Qualifications of the Directors.** — Any person of sound mind who is capable of acting as agent for another may be elected director or trustee of a corporation, unless some special qualification is prescribed by the charter or by-laws of the company.⁶

¹ *Supra*, § 474.

² *Supra*, § 338. *Santa Clara Mining Ass. v. Meredith*, 49 Md. 389; *Crowley v. Genesee Mining Co.*, 55 Cal. 273; *White v. State*, 69 Ind. 273.

³ *Cameron v. Seaman*, 69 N. Y. 396, and cases in the following note.

⁴ See *Lockwood v. Mechanics' Nat. Bank*, 9 R. I. 308; *Delano v. Smith Charities*, 138 Mass. 63. Compare *Blake v. Bayley*, 16 Gray, 531; *Re Peninsular, &c. Bank*, L. R. 2 Eq. 435.

⁵ *Infra*, §§ 636-638.

⁶ It seems that a married woman

may be a trustee of a corporation, unless the contrary be provided by charter. *People v. Webster*, 10 Wend. 554. And there appears to be no reason why a person under the age of twenty-one years should not be eligible, if of sufficient intelligence to perform the duties of the office.

The inspectors at an election of directors have no power to pass upon the eligibility of the persons for whom votes are offered. *Re St. Lawrence Steamboat Co.*, 44 N. J. Law, 529, 541.

It is not necessary that a director should be a shareholder also, unless this be expressly required by the company's charter;¹ and a director may at the same time act as secretary or managing agent, unless this be expressly prohibited.²

§ 506. **When Directors must be Shareholders.** — The directors of a corporation are generally required to be shareholders by express provision of the company's charter or articles of association. A person is a shareholder within the meaning of a provision of this description if he holds shares on the books of the company, but not if he is merely the holder of a certificate. It has been held that a transferee on the books is eligible, although he is not the real owner of the shares, and the transfer was executed for the sole purpose of making him a director.³ A different rule might apply where the statute expressly requires the directors to be the *owners* of shares. The question is as to the meaning of the charter or act of incorporation.

It seems that the bankruptcy of a director does not vacate his office, even though the charter requires the directors to be shareholders.⁴

§ 507. **Powers of Directors who are not qualified.** — The majority of a corporation have no power to elect a person to the office of director if he is not eligible by the terms of the company's charter; and a person who is not qualified to act as director has no authority to represent the corporation. But the corporation, by general consent of its shareholders, may waive the disqualification;⁵ and persons dealing with

¹ *State v. McDaniel*, 22 Ohio St. 354. Compare *Despatch Line v. Bellamy Manuf. Co.*, 12 N. H. 205; *Bartholomew v. Bentley*, 1 Ohio St. 37; *Re St. Lawrence Steamboat Co.*, 44 N. J. Law, 529, 541; *Cumming v. Prescott*, 2 Y. & C. 488; *Stock's Case*, 33 L. J. Ch. 731.

² *Sargent v. Webster*, 13 Metc. (Mass.) 497.

³ *State v. Leete*, 16 Nev. 242. Compare *State v. Hunton*, 28 Vt. 595.

Under the general incorporation act of New York, of 1848, the directors named in the certificate of incorporation to manage the company for the first year are not required to be shareholders. *Davidson v. Westchester Gas Light Co.*, 99 N. Y. 558.

⁴ *Atlas Nat. Bank v. Gardner Co.*, 8 Biss. 537; *Phelps v. Lyle*, 10 A. & E. 113.

⁵ *Infra*, §§ 636, 638. See *People v. Northern R. R. Co.*, 42 N. Y.

a director actually elected by the majority, and held out to the world as a director, would generally be entitled to assume that the election was valid, and that all conditions precedent were complied with.¹

§ 508. **Compensation of Directors.** — It would be contrary to established principles to allow the directors or other agents of a corporation to fix their own compensation for services rendered to the company.² Directors are not entitled to any compensation for their official services as directors, unless compensation is provided for by the charter or the by-laws adopted by the majority.³ But if a director is properly employed to perform services which do not pertain to his office as director, he is entitled to such compensation as has been agreed upon, or as the services are reasonably worth.⁴

§ 509. **The Extent of the Authority of Agents. — General Rule.** — The extent of the authority of the various agents of a corporation depends upon the terms of their appointment, and upon the provisions of the company's charter. It is clear that no agent of a corporation can, under any circumstances, have authority to do an act in excess of the company's chartered powers, or in violation of the law.⁵ The extent of the powers of agents of a well-defined class, such as presidents, directors, or cashiers, is determined largely by general custom, of which the courts will take judicial notice; and parties dealing with such agents are entitled to assume that they

217; *Atlas Nat. Bank v. Gardner Co.*, 8 Biss. 537.

¹ *Infra*, § 637.

² See *Loan Ass. v. Stonemetz*, 29 Pa. St. 534; *Citizens' Nat. Bank v. Elliott*, 55 Iowa, 104; 7 N. W. Rep. 470; *Holder v. Lafayette, &c. Ry. Co.*, 71 Ill. 106; *Maux Ferry Gravel R. Co. v. Branegan*, 40 Ind. 361; *Illinois Linen Co. v. Hough*, 91 Ill. 63; *Jones v. Morrison*, 31 Minn. 140; *Blatchford v. Ross*, 5 Abb. Pr. N. s. 434; s. c. 54 Barb. 42. Compare *Davis v. Memphis*

City Ry. Co., 22 Fed. Rep. 883. *Infra*, § 517 *et seq.*

³ *Citizens' Nat. Bank v. Elliott*, 55 Iowa, 104; *Lafayette, &c. Ry. Co. v. Cheeney*, 87 Ill. 446; *First Nat. Bank v. Drake*, 29 Kans. 311, and cases there cited; *Santa Clara Mining Ass. v. Meredith*, 49 Md. 389, 400.

⁴ See cases cited in notes 2 and 3.

⁵ *Alexander v. Cauldwell*, 83 N. Y. 480; *Planters' Warehouse Co. v. Johnson*, 62 Ga. 308; and see *infra*, § 580.

possess all the powers which are usually accorded to agents of the class to which they belong.¹

The authority of the subordinate agents of a corporation often depends upon the course of dealing which the company or its directors have sanctioned. It may be established, without reference to the official record of the proceedings of the board, by proof of the usages which the company has permitted to grow up in its business, and of the acquiescence of the board charged with the duty of supervising and controlling the company's business.²

Thus, although the secretary and treasurer of a corporation have no authority, by virtue of their office, to sell the corporate property, or to issue corporate obligations,³ yet they may be invested with this authority by resolution of the board of directors, or acquiescence in a course of dealing.⁴ The Superior Court of California said: "The result of the cases seems to be, that where the management of the affairs of a corporation is intrusted to a general managing agent, he has power to assign the choses in action of the corporation to its creditors, either in payment of, or as security for the payment of, a precedent debt of the corporation, without express authority from the board of directors, and an assignment so made is valid."⁵

¹ See *infra*, § 585 *et seq.* Spangler v. Butterfield, 6 Col. 356.

It has been held that the courts will take judicial notice of the authority of the managing agents of a railroad company. *Sacalaris v. Eureka, &c. R. R. Co.*, 18 Nev. 155.

² See *Mining Co. v. Anglo-Californian Bank*, 104 U. S. 192; *Martin v. Webb*, 110 U. S. 7, 15; *Lohman v. New York, &c. R. R. Co.*, 2 Sandf. 39, 52; *Fulton Bank v. New York, &c. Canal Co.*, 4 Paige, 127; *Protection Life Ins. Co. v. Foote*, 79 Ill. 361; *Foster v. Ohio, &c. Mining Co.*, 17 Fed. Rep. 130; *Talladega Ins. Co. v. Peacock*,

67 Ala. 253; *Perkins v. Bradley*, 24 Vt. 66. Compare *New England Fire, &c. Ins. Co. v. Schettler*, 38 Ill. 166; *Whitney v. South Paris Manuf. Co.*, 39 Me. 316.

³ *Fawcett v. New Haven Organ Co.*, 47 Conn. 224; *Bradlee v. Warren, &c. Savings Bank*, 127 Mass. 107; *McCullough v. Moss*, 5 Denio, 567.

⁴ *Phillips v. Campbell*, 43 N. Y. 271. *Infra*, §§ 534-540.

⁵ *McKiernan v. Lenzen*, 56 Cal. 61, 64.

A general managing agent of a mining company has no implied authority to issue negotiable paper on behalf of the company, because that would not be necessarily incidental

§ 510. **The Powers of the Board of Directors.** — The active management and direction of the affairs of a business corporation are ordinarily vested in a board of directors or trustees. The board of directors of a corporation have implied authority to do all acts in the management of the company's *regular* business, which the company itself can do without a departure from its chartered powers. Accordingly, in *Burrill v. Nahant Bank*,¹ Chief Justice Shaw said: "A board of directors of the banks of Massachusetts is a body recognized by law. By the by-laws of these corporations, and by a usage, so general and uniform as to be regarded as part of the law of the land, they have the general superintendence and active management of all the concerns of the bank, and constitute, to all purposes of dealing with others, the corporation."

The same rule applies to the directors or trustees of all other corporations engaged in business enterprises.²

§ 511. **Powers belonging to the Directors exclusively.** — The directors of a corporation should be men of practical business experience and judgment, and should be selected by the majority by reason of their peculiar fitness to manage the corporate affairs. Although the appointment of the directors rests with the majority, it does not follow that the majority can control them or interfere with their management of the business of the company. The authority of the board of directors is derived from the unanimous agreement of the shareholders, expressed in their charter or articles of association; and hence those powers which it is intended shall belong to the directors exclusively cannot be impaired by the majority, or any other agent. Each agent is supreme within

to the management of the business of such a company. *New York Iron Mine v. First Nat. Bank*, 39 Mich. 644.

¹ *Burrill v. Nahant Bank*, 2 Metc. (Mass.) 163, 166.

² *Hoyt v. Thompson*, 19 N. Y. 207, 216; *Bank of Middlebury v. Edgerton*, 30 Vt. 182; *Miller v. Rutland, &c. R. R. Co.*, 36 Vt. 452;

Maynard v. Fireman's Fund Ins. Co., 34 Cal. 48; *Wright v. Oroville Mining Co.*, 40 Cal. 20; *Tripp v. Swanzey Paper Co.*, 13 Pick. 291; *Union Mut. Fire Ins. Co. v. Keyser*, 32 N. H. 313; *Railroad Co. v. Furnace Co.*, 37 Ohio St. 321; *Genesee County Savings Bank v. Michigan Barge Co.*, 52 Mich. 438.

the scope of the powers expressly delegated to him by his principal.

The rule limiting the powers of the majority to the general supervision of the affairs of the corporation, and the appointment of the regular managing agents, is established for the protection of the individual shareholders, as well as for reasons of practical convenience. It is obvious that a board of directors, selected by the shareholders of a corporation on account of their known business experience and capacity, are far better adapted to carry on the business of the company successfully, than the shareholders themselves assembled at a general meeting.

Accordingly, in *Conro v. Port Henry Iron Co.*¹ it was held that a lease executed in pursuance of a resolution of the shareholders of a corporation was void, because the power of managing the business of the company was vested solely in the board of directors. Willard, P. J., delivering the opinion, said: "It is quite obvious, from the charter, that the company could do no act except through its directors. When the charter prescribes the mode of action, its injunctions must be rigidly pursued. When no specific mode of action has been prescribed, the common law mode of acting may be inferred; but every corporation created by statute must act as the statute prescribes, and the common law cannot control by implication that which the legislature has expressly sanctioned. The stockholders in this case had no power to make a lease, or do any other administrative act in the management of the affairs of the corporation. If a lease could be made at all, it could be executed only in pursuance of the act of the directors, who are the body appointed by the charter for the management of its affairs."²

¹ 12 Barb. 27, 63.

² See also *Union Gold Mining Co. v. Rocky Mt. Nat. Bank*, 2 Col. 565-575; *Union Mut. Fire Ins. Co. v. Keyser*, 32 N. H. 313; *Dana v. Bank of U. S.*, 5 W. & S. 223, 245-247; *Dayton, &c. R. Co. v. Hatch*, 1 Disney, 84; *Charlestown*

Boot, &c. Co. v. Dunsmore, 60 N. H. 85; *Tracy v. Guthrie County, &c. Society*, 47 Iowa, 27; *Gashwiler v. Willis*, 38 Cal. 12; *Commonwealth v. St. Mary's Church*, 6 S. & R. 508; *State v. Bank of Louisiana*, 6 La. 746-763.

Compare *Hoyt v. Thompson*, 19

However, the exclusive powers of the board of directors extend only to the management of the regular business of the corporation. Even an express provision that the powers of the corporation shall be exercised by its board of directors does not deprive the majority of the power of directing the general policy of the corporation, and of deciding upon the propriety of important changes in the company's business."

§ 512. **Directors have no Authority to make Important Changes.**—The general authority of the directors of a corporation extends merely to the supervision and management of the company's ordinary or regular business. A board of directors has no implied authority to make a material and permanent alteration of the business or constitution of a corporation, even though the alteration be within the company's chartered powers. Such an alteration can be effected only by authority of the shareholders at a general meeting.

This was decided by the Supreme Court of the United States in *Railway Company v. Allerton*.¹ In that case, a shareholder of a city railway company obtained an injunction to restrain the directors of the company from increasing the amount of its capital stock. The charter of the company provided expressly that "the capital stock of said corporation shall be one hundred thousand dollars, and may be increased from time to time, at the pleasure of said corporation"; it also contained a provision that "all the corporate powers of said corporation shall be vested in and exercised

N. Y. 216; *Despatch Line v. Belamy Manuf. Co.*, 12 N. H. 226; *Salem Bank v. Gloucester Bank*, 17 Mass. 29, 30; *Oregonian Ry. Co. v. Oregon Ry. & Nav. Co.*, 23 Fed. Rep. 232, 244; *Newby v. Oregon Central Ry. Co.*, 1 Dedy, 616; *Wells v. Oregon Ry. & Nav. Co.*, 8 Sawy. 600, 608. See also *supra*, § 475.

¹ *Railway Co. v. Allerton*, 18 Wall. 233. See also *Eidman v. Bowman*, 58 Ill. 444; *Finley Shoe &c. Co. v. Kurtz*, 34 Mich. 89. Nor

can the directors of a corporation reduce the amount of its capital. See *Percy v. Millaudon*, 3 La. 569, 587; *supra*, § 434.

It has also been held that the directors of a railway company cannot execute a lease of the company's entire property, though the majority have this power. *Martin v. Continental Pass. Ry. Co.*, 14 Phila. 10. See also *Metropolitan Elevated R. R. Co. v. Manhattan Elevated R. R. Co.*, 11 Daly, 377, 430; *Flagg v. Manhattan Ry. Co.*, 20 Blatchf. 142.

by a board of directors, and such officers and agents as said board shall appoint." But the court held that the latter clause referred merely to the ordinary business transactions of the company, and that an increase of the capital stock could be effected only by vote of the majority at a shareholders' meeting. Mr. Justice Bradley, delivering the opinion, said: "We are satisfied that the decree must be affirmed on the broad ground that a change so organic and fundamental as that of increasing the capital stock of a corporation beyond the limit fixed by the charter cannot be made by the directors alone, unless expressly authorized thereto. The general power to perform all corporate acts refers to the ordinary business transactions of the corporation, and does not extend to a reconstruction of the body itself, or to an enlargement of its capital stock."

§ 513. **Nor can they wind up the Business of the Corporation.** — Upon the same principle, it has been held that the directors of a corporation have no implied authority to wind up the company, or to sell any property which is necessary in order to carry on its business. Directors are merely agents, and they are appointed for the purpose of managing the business in which the shareholders have agreed to unite; the value of this business as a commercial speculation, and the advisability of continuing it, are matters which concern those who have embarked in it, and not their managing agents.¹

But it is the duty of the directors of a corporation to pay its debts; and they are justified in using the corporate assets for this purpose, although the company be thereby disabled

¹ Bank Commissioners v. Bank of Brest, 1 Harring. Ch. (Mich.) 106, 111; Rollins v. Clay, 33 Me. 132; Abbott v. American Hard Rubber Co., 33 Barb. 578; Ernest v. Nicholls, 6 H. L. Cas. 401. Compare Wilson v. Miers, 10 C. B. N. S. 348; Bank of Switzerland v. Bank of Turkey, 5 L. T. N. S. 549.

Under the bankrupt law the di-

rectors of a corporation could not direct the filing of a petition to have the company adjudged bankrupt, as the act expressly required that the petition be "duly authorized by a vote of the majority of the corporators at any legal meeting called for the purpose." *Re Lady Bryan Mining Co.*, 2 Abb. (U. S.) 527.

from carrying on its business, provided they act in good faith, with a due regard to the interests of all the shareholders.¹ It has been held that the directors of an insolvent corporation may convey the whole of its assets to a trustee for the payment of creditors.²

§ 514. **Directors cannot depart from the Company's chartered Purposes.** — It is a fundamental principle, that the authority of every agent of a corporation is derived directly or indirectly from the unanimous agreement of the shareholders, as expressed in their charter or articles of association. The board of directors are impliedly authorized to do all acts which are proper to carry out the company's chartered purposes, but they cannot depart from these purposes under any circumstances.

In *Pickering v. Stephenson*,³ the directors of a railway company were restrained, at the suit of a shareholder from applying the company's funds in payment of the costs of a prosecution for libel brought by them against a person who had been in the employ of the company. Sir John Wickens, V. C., said: "The principle of jurisprudence which I am asked here to apply is, that the governing body of a corporation that is in fact a trading partnership cannot, in general, use the funds of the community for any purpose other than those for which they were contributed. By the governing body I do not, of course, mean exclusively either directors or a general council; but the ultimate authority within the society itself, which would ordinarily be a majority at a general meeting. According to the principle in question, the special powers, given either to the directors or to a majority by the statutes or other constituent documents of the association, however absolute in terms, are always to be construed as

¹ *Seuble*, *Sheldon Hat Blocking Co. v. Eickemeyer Hat, &c. Machine Co.*, 56 How. Pr. 70; 90 N. Y. 613.

² *De Camp v. Alward*, 52 Ind. 473; *Sargent v. Webster*, 13 Metc. (Mass.) 497; *Dana v. Bank of U. S.*, 5 W. & S. 223, 247; *Merrick v. Bank of Metropolis*, 8 Gill, 59; *Reichwald v.*

Commercial Hotel Co., 106 Ill. 439. Compare *infra*, § 802; *contra*, *Bank Commissioners v. Bank of Brest*, 1 Harring. Ch. (Mich.) 106; *Gibson v. Goldthwaite*, 7 Ala. 281; *Eppright v. Nickerson*, 78 Mo. 482.

³ *Pickering v. Stephenson*, L. R. 14 Eq. 322, 340.

subject to a paramount and inherent restriction that they are to be exercised in subjection to the special purposes of the original bond of association. This is not a mere canon of English municipal law, but a great and broad principle, which must be taken, in absence of proof to the contrary, as part of any given system of jurisprudence.”¹

It is clear that the directors of a corporation can under no circumstances make or accept an alteration of the company's charter, unless the power to do this is expressly conferred upon them by a provision contained in the charter itself.²

§ 515. **Powers of Directors are derived from the Shareholders.** — In some of the cases it has been said that the powers of the board of directors which are given in terms by the act of incorporation are derived from the legislature, and not from the shareholders of the company.³ This view is certainly not strictly correct. The function of the legislature in forming a private corporation is solely to legalize the agreement of its shareholders; and those provisions in an act of incorporation which prescribe the purposes of the corporation, and the powers of its agents, merely indicate the nature of the association which the shareholders are authorized to form. The shareholders consent and agree that the business of the corporation shall be carried on in the manner and by the agencies prescribed by the charter, either in express or implied terms. Every agent who has authority to represent the collective body of shareholders must necessarily derive his powers from the consent of the shareholders themselves.

§ 516. **The Fiduciary Relation between a Corporation and its Directors.** — It is clear that the directors or managing agents of a corporation are not trustees in a technical sense, although they are often called trustees in practice; they are merely agents, invested with wide discretionary powers in the management of the company's business.

¹ To similar effect see *Minor v. Gold, &c. Mining Co.*, 10 Phila. 32; *Mechanics' Bank*, 1 Pet. 71, *per* Blatchford *v. Ross*, 5 Abb. Pr. N. s. 434; *Dayton, &c. R. R. Co. v. Hatch*, Justice Story.

² See *supra*, § 395. Compare *1 Disney (Ohio)*, 84. *Marlborough Manuf. Co. v. Smith*, ³ See *Hoyt v. Thompson*, 19 N. Y. 2 Conn. 583; *Brown v. Fairmount* 216.

The relation between the directors of a corporation and the company itself is, however, in many respects, a fiduciary or trust relation. Whenever an agent is invested with authority to use any discretion in the exercise of the powers conferred upon him, it is an implied condition that this discretion shall be used in good faith for the benefit of the principal, and in accordance with the true purpose of the agent's appointment. To this extent, every agency which is not a purely ministerial one involves a fiduciary relation between the parties.

The directors of a corporation are ordinarily invested with the most extensive powers of management. They are empowered to represent the company in all of its business transactions and ventures; and the entire corporate affairs are placed in their charge, upon the trust and confidence that they shall be cared for and managed for the common benefit of the shareholders, and in accordance with the provisions of the charter agreement. It is manifest, therefore, that the directors of a corporation occupy a position of the highest trust and confidence, and that the utmost good faith is required in the exercise of the powers conferred upon them.¹

§ 517. Directors or Agents have no Authority to represent the Corporation in Transactions for their Personal Advantage. — The directors or trustees of a corporation, in accepting their appointment to office, impliedly undertake to give the company the benefit of their best care and judgment, and to

¹ "Whether a director of a corporation is to be called a trustee or not, in a strict sense there can be no doubt that his character is fiduciary, being intrusted by others with powers which are to be exercised for the common and general interests of the corporation, and not for his private interests. He falls, therefore, within the great rule by which equity requires that confidence shall not be abused by the party in whom it is reposed, and which it enforces by imposing a disability, either par-

tial or complete, upon the party intrusted to deal, on his own behalf, in respect of any matter involved in such confidence." *Hoyle v. Plattsburgh, &c. R. R. Co.*, 54 N. Y. 314, 328, *per* Johnson, C. See also *Cumberland Coal Co. v. Sherman*, 30 Barb. 553, 559-577, and authorities cited. *Booth v. Robinson*, 55 Md. 419, 436; *York, &c. Ry. Co. v. Hudson*, 16 Beav. 485; and see cases cited in the following sections.

use the powers conferred upon them solely in the interest of the corporation. They have no right under any circumstances to use their official positions for their own benefit or the benefit of any one except the corporation itself. It is for this reason that the directors have no authority to represent the corporation in any transaction in which they are personally interested in obtaining an advantage at the expense of the company. The corporation would not have the benefit of their disinterested judgment under these circumstances, as self-interest would prompt them to prefer their own advantage to that of the company.

Accordingly, it has been held, in numerous cases, that the directors of a corporation have no authority to bind the company to any contract made with themselves personally, or to represent it in any transaction with third persons, in which they have a private interest at stake.¹ The

¹ See *Wardell v. Union Pacific R. R. Co.*, 4 Dill. 330; 103 U. S. 651; *Koehler v. Black River Falls Iron Co.*, 2 Black, 715; *Thomas v. Brownsville, &c. Ry. Co.*, 1 McCr. C. Ct. 392; *Cook v. Sherman*, 20 Fed. Rep. 167, 175, and cases cited in notes.

See also *Aberdeen Ry. Co. v. Blakie*, 1 Macq. Sc. App. 461, 471; *Flanagan v. Great Western Ry. Co.*, L. R. 7 Eq. 116; *Murphy v. O'Shea*, 2 Jones & La T. 422; *Jones v. Morrison*, 31 Minn. 140, 147; *Risley v. Indianapolis, &c. Ry. Co.*, 1 Hun, 202, reversed 62 N. Y. 240; *Coleman v. Second Ave. R. R. Co.*, 38 N. Y. 201; *Butts v. Wood*, 37 N. Y. 317; 38 Barb. 181; *Hoyle v. Plattsburgh, &c. R. R. Co.*, 54 N. Y. 314; *Blake v. Buffalo Creek R. R. Co.*, 56 N. Y. 485; *Morrison v. Ogdensburgh, &c. R. R. Co.*, 52 Barb. 173; *Ogden v. Murray*, 39 N. Y. 202; *Bliss v. Matteson*, 45 N. Y. 22; 52 Barb. 348; *Buffalo, &c. R. R. Co. v. Lampson*, 47 Barb. 533; *Conro v. Port*

Henry Iron Co., 12 Barb. 64; *Blatchford v. Ross*, 5 Abb. Pr. n. s. 434; *Gray v. New York, &c. Steamship Co.*, 3 Hun, 383; *Abbot v. American Hard Rubber Co.*, 33 Barb. 578; *Cumberland Coal, &c. Co. v. Sherman*, 30 Barb. 553; *Cumberland Coal, &c. Co. v. Parish*, 42 Md. 598; *European, &c. Ry. Co. v. Poor*, 59 Me. 277; *Flint, &c. Ry. Co. v. Dewey*, 14 Mich. 477; *Alford v. Miller*, 32 Conn. 543; *Redmond v. Dickerson*, 9 N. J. Eq. 507; *Covington, &c. R. R. Co. v. Bowler*, 9 Bush, 468; *Port v. Russell*, 36 Ind. 60; *Paine v. Lake Erie, &c. R. R. Co.*, 31 Ind. 283; *Cook v. Berlin Woolen Mill Co.*, 43 Wis. 433; *Bestor v. Wathen*, 60 Ill. 138; *Harts v. Brown*, 77 Ill. 227; *Gilman, &c. R. R. Co. v. Kelly*, 77 Ill. 426, 435; *McAler v. McMurray*, 58 Pa. St. 126; *Simons v. Vulcan Oil, &c. Co.*, 61 Pa. St. 202; *Rice's Appeal*, 79 Pa. St. 168; *Percy v. Millaudon*, 3 La. 568, 587; *Levisse v. Shreveport City R. R. Co.*, 27 La. Ann. 641;

principle acted upon in these cases is a general principle of the law of agency, and applies to every agent of a corporation, whatever may be his position. Thus, a president, cashier, or managing agent, having authority to sign the name of the corporation to negotiable instruments, cannot execute a note or indorse a note to himself,¹ or certify a check for his own benefit.² It is a general rule, that the powers conferred upon an agent must be exercised to advance the interests of the principal, and for no other purpose.³

§ 518. The same rule applies in all cases where the directors attempt to obtain an advantage to themselves through their control over the company. The directors of a corporation have no right to use either its assets or its credit, or any of the powers of their office, except to advance the interests of the company, irrespective of their own advantage or desires.⁴ Thus, it has often been decided that the directors have no right to stipulate for a bonus or commission to be paid them by a person with whom they enter into a contract on behalf of the company,⁵ and it is equally well settled that they cannot by any arrangement secure to themselves a share in the profits of any transaction to which the company is a party.

First Nat. Bank v. Gifford, 47 Iowa, 575; *Blair Town Lot, &c. Co. v. Walker*, 50 Iowa, 376; *Gardner v. Butler*, 30 N. J. Eq. 702, 721; *Stewart v. Lehigh Valley R. R. Co.*, 38 N. J. Law, 505; *Guild v. Parker*, 43 N. J. Law, 430; *Ryan v. Leavenworth, &c. Ry. Co.*, 21 Kans. 365; and see cases cited in the following notes.

In England, the common law rule is reinforced by provisions in the various companies acts. It has been provided that the office of a director who is interested in a transaction with the company shall be vacated. See 7 & 8 Vict. ch. 110, § 29; 8 & 9 Vict. ch. 16, §§ 85; 86, 87; Companies Act of 1862, 25 & 26 Vict. ch. 89, Table A, No. 57.

¹ *West St. Louis Sav. Bank v. Shawnee County Bank*, 95 U. S. 557; 3 Dill. 403; *Gallery v. Nat. Exchange Bank*, 41 Mich. 169; *Chamberlain v. Pacific Wool Growing Co.*, 54 Cal. 103.

² *Claffin v. Farmers', &c. Bank*, 25 N. Y. 293; 24 How. Pr. 1.

³ *Gallery v. Nat. Exchange Bank*, 41 Mich. 169.

⁴ *York, &c. Ry. Co. v. Hudson*, 16 Beav. 485; *Blair Town Lot, &c. Co. v. Walker*, 50 Iowa, 376; *Gaskell v. Chambers*, 26 Beav. 360; and see cases cited in next note.

⁵ *Imperial, &c. Ass. v. Coleman*, L. R. 6 H. L. 189, reversing L. R. 6 Ch. 558; *Dunne v. English*, L. R. 18 Eq. 524; *General Exchange Bank v. Horner*, L. R. 9 Eq. 480; *Gaskell*

This principle was applied by the Supreme Court of the United States in *Koehler v. Black River Falls Iron Co.* The directors of a mining company, which was largely in debt, were empowered by the shareholders to obtain a loan of money for the purpose of carrying on the company's business, and to execute a mortgage of the company's property as security; but instead of honestly endeavoring to effect a loan of money, advantageously, for the benefit of the company, they executed a note and mortgage for \$15,000, in consideration of a loan of \$2,000 in money and provisions, and an undertaking on the part of the mortgagee to assume the payment of debts amounting to over \$9,000, which the company owed to individual directors. The court held that the transaction was unauthorized, and that the mortgage was invalid. Mr. Justice Davis, after stating the facts of the case, said: "Directors cannot thus deal with the important interests intrusted to their management. They hold a place of trust, and by accepting the trust are obliged to execute it with fidelity, not for their own benefit, but for the benefit of the stockholders of the corporation."¹

§ 519. It is clear that a director has no right to sell his influence in the management of the company, or to enter into any agreement by which his official action would be influenced or controlled. Such an agreement would be dishonest and illegal; it would be an agreement to commit a breach of trust.²

It has also been held that a director cannot become a purchaser of property of the corporation at an execution sale,

v. Chambers, 26 Beav. 360; *Madrid Bank v. Pelly*, L. R. 7 Eq. 442.

¹ *Koehler v. Black River Falls Iron Co.*, 2 Black, 715, 720. See also *Davis v. Rock Creek, &c. Mining Co.*, 55 Cal. 359; *Farmers', &c. Bank v. Downey*, 53 Cal. 466; *Rhodes v. Webb*, 24 Minn. 292.

² *Bliss v. Matteson*, 45 N. Y. 26; *Berryman v. Cincinnati Southern Ry. Co.*, 14 Bush, 755.

A contract made by the officers of a railroad company to purchase

for their own benefit lands along the line of the projected road, with the view of increasing the value of their lands by locating the railroad and its depots and stations near these lands, cannot be enforced in equity. "The law does not permit these officials to subject themselves to any temptation to serve their own interests, in preference to the interests of the stockholders and of the public." *Per McCrary, J.*, in *Cook v. Sherman*, 20 Fed. Rep. 167.

except subject to the right of the company to elect to disaffirm the sale and demand a resale.¹

§ 520. **Interest of Directors in other Company disqualifies them from dealing with it.** — The rule disqualifying an agent from representing his principal in any transaction in which his personal interests are opposed to the interests of the principal, applies in all cases where there is danger that the agent may be induced to use his powers for his own advantage. It is immaterial what the character of the interest of the agent may be, provided it be a substantial one. Thus, the directors of a corporation have no authority to represent it in transactions with another corporation in which they are shareholders, if their interest in the latter company might induce them to favor it at the expense of the company whose interests have been intrusted to their care.²

In *Wardell v. Union Pacific Railroad Co.*,³ Justice Field said: "All arrangements by directors of a railroad company, to secure an undue advantage to themselves at its expense, by the formation of a new company as an auxiliary to the original one, with an understanding that they or some of them shall take stock in it, and then that valuable contracts shall be given to it, in the profits of which they as stockholders in the new company are to share are so many unlaw-

¹ *Hoyle v. Plattsburgh, &c. R. R. Co.*, 54 N. Y. 314, 329.

In this case, Johnson, C., delivering the opinion of the court, said: "As director, it was his duty to prevent a sale if possible; and if not, then to endeavor to have the property produce the highest price; and in order to the attainment of these objects, to use the knowledge he had derived from the confidence reposed in him as director. As purchaser, on the other hand, it was his interest to pay as little as possible, and to use his special knowledge for his own advantage. Actual fraud or actual advantage do not need, in such cases, to be shown."

See also *Cumberland Coal, &c.*

Co. v. Sherman, 30 Barb. 553; *Jones v. Arkansas Mechanical, &c. Co.*, 38 Ark. 17. Compare *Kitchen v. St. Louis, &c. Ry. Co.*, 69 Mo. 224; *Pioneer Gold Mining Co. v. Baker*, 20 Fed. Rep. 4; s. c. 23 Fed. Rep. 258.

² *Gilman, &c. R. R. Co. v. Kelly*, 77 Ill. 426; *Ryan v. Leavenworth, &c. Ry. Co.*, 21 Kans. 365; *Thomas v. Brownsville, &c. Ry. Co.*, 1 McCr. C. Ct. 392; *San Diego v. San Diego, &c. R. R. Co.*, 44 Cal. 106. Compare *Aberdeen Ry. Co. v. Blakie*, 1 Macq. Sc. App. 461.

³ *Wardell v. Union Pacific R. R. Co.*, 103 U. S. 651, 658; *Abbot v. American Hard Rubber Co.*, 33 Barb. 578.

ful devices to enrich themselves to the detriment of the stockholders and creditors of the original company, and will be condemned whenever properly brought before the courts for consideration."

It is clear that the directors of a railroad company have no right to make contracts on behalf of the company for the construction or equipment of its road by a construction company in which they are interested as shareholders. And even if they were not interested in the construction company at the time when the contract was entered into, they would have no right to become shareholders thereafter and continue to act as directors of the railroad company. Their interest in adding to the profits of the construction company by allowing the railroad to be built cheaply and imperfectly, would be opposed to their duty to the railroad company to insist upon a strict performance of the contract, and a careful construction of the road.¹

§ 521. *Qualification of the Rule.* — But the rule referred to is not an arbitrary one; it is founded on reason, and should not be applied without regard to the circumstances of the case. A merely nominal or a naked legal interest in the subject matter of a transaction would not disqualify an agent from representing his principal in the transaction, if there is no temptation to the agent to obtain an advantage at the expense of the principal;² there must be a real and substantial inducement to the agent to sacrifice the interest of the principal. Thus, a director ought not to be held disqualified from representing the corporation in a transaction with another company merely because he is a shareholder in the latter, if the amount of his stock is so small that his interest in the transaction would be practically insignificant.

A director or other agent of a corporation may deal with the company provided it be adequately represented by other agents;³ he may also purchase property, and afterwards sell

¹ *Gilman, &c. R. R. Co. v. Kelly*, 77 Ill. 426.

² *Bank v. Flour Co.*, 41 Ohio St. 552. Compare *Hopson v. Ætna Axle, &c. Co.*, 50 Conn. 597.

A director may take a convey-

ance of property to himself as trustee for the benefit of creditors, if he has no personal interest. *Bassett v. Monte Christo Mining Co.*, 15 Nev. 293.

³ *Infra*, § 527.

it to the corporation at an advance, provided it was not his duty, when he made the purchase, to purchase on behalf of the company.¹ So, an agent of a corporation may purchase claims against the company at a discount, and enforce them in full, if he was not under obligation to make the purchase on behalf of the corporation.²

§ 522. **The Corporation has an absolute Right to repudiate unauthorized Transactions.**—The right of a principal to refuse to be bound by a transaction in which the agent assuming to represent him has an adverse interest, is unconditional. It is immaterial whether the transaction was fair to the principal or not. The incapacity of the agent to act in a case of this kind results from an implied limitation of the authority delegated by the principal; and this limitation is implied in all cases, because sound policy obviously demands that an agent should never be led into the temptation of placing his interest in conflict with his duty. In many cases, it would be impossible to ascertain whether the agent did or did not obtain the best terms for the principal which it was possible to obtain.³ But the principal would always have the privilege of adopting the contract made on his behalf, if he should so desire, and ratification would usually be implied, in a case of this kind, from a failure to dissent. In applying these doctrines to unauthorized contracts made by directors of a corporation for their own benefit, it should be observed that the duty of the directors would ordinarily compel them to adopt a transaction which proves to be clearly beneficial

¹ *Parker v. Nickerson*, 137 Mass. 487. Compare *infra*, §§ 545, 546. *Michoud v. Girod*, 4 How. 503, 557; *Wardell v. Union Pacific R. R.*

² *Bradley v. Marine, &c. Manuf. Co.*, 3 Hughes, 26; *Inglehart v. Thousand Island Hotel Co.*, 32 Hun, 377. *Co.*, 103 U. S. 651; *Pearson v. Concord R. R. Co.*, 13 Am. & Eng. R. R. Cas. 102, 111, and cases there cited.

³ *Aberdeen Ry. Co. v. Blakie*, 1 Macq. Sc. App. 461, 471; *Stewart v. Lehigh Valley R. R. Co.*, 38 N. J. Law, 523; *Hoyle v. Plattsburgh, &c. R. R. Co.*, 54 N. Y. 314; *Jewett v. Miller*, 10 N. Y. 402, 405; *Flint, &c. Ry. Co. v. Dewey*, 14 Mich. 477; *It is submitted that the dicta to the contrary in Twin Lick Oil Co. v. Marbury*, 91 U. S. 587, *Buell v. Buckingham*, 16 Iowa, 284, *Kitchen v. St. Louis, &c. Ry. Co.*, 69 Mo. 224, and other cases, ought not to be followed.

to the company, and to repudiate an unauthorized transaction which proves injurious.

§ 523. **The legal Effect of unauthorized Acts and Contracts.**—The power of an agent to bind the principal by contract, or to dispose of his property, depends entirely upon the measure of authority delegated by the principal. If an agent enters into an unauthorized contract, or makes an unauthorized disposition of property belonging to the principal, the latter is not bound by the transaction, either at law or in equity, unless he is estopped from denying the authority of the agent to bind him.

There is an important difference in this respect between the legal effect of an unauthorized act of a *trustee* and an unauthorized act of a mere *agent*. A trustee has the legal title to the trust property, and can dispose of the legal title to the property absolutely, the rights of the *cestui que trust* being ignored at law. It is for this reason that a misapplication of trust property can be remedied only by a court of equity. An agent, on the other hand, has not the legal ownership of the property placed in his charge, and cannot deal with the property in the name of the principal, except in pursuance of the authority delegated by the latter.

The directors or trustees of a corporation are mere agents; they have not the legal title to the corporate property. Hence, if the directors enter into an unauthorized contract, or make an unauthorized application of property belonging to the corporation, the latter is not bound either at law or in equity unless estopped from setting up the excess of authority.¹ This rule is applicable where the directors attempt to use their powers for their personal advantage at the expense of the corporation. If the directors or other agents of a corporation enter into a contract with themselves personally, or if they use the corporate property or credit in any transaction in which they are personally interested, the corporation is not bound by the contract or the use of its property or name, because the agents assuming to represent it have no authority under these circumstances.²

¹ *Infra*, §§ 577–584.

Macq. Sc. App. 461; *Flanagan v.*

² *Aberdeen Ry. Co. v. Blakie*, 1 Great Western Ry. Co., L. R. 7 Eq.

§ 524. **Whether Unauthorized Contracts are Void or Voidable.** — It has been said by some of the judges, that a contract or sale made by a director or agent for his personal benefit is "voidable" by the principal, but not absolutely "void."¹ The precise sense in which the terms *void* and *voidable* are here used is not clear; but it is evidently not the ordinary sense. The expression "void contract" usually signifies, either that there is no contract at all, by reason of the absence of some element essential to the existence of contract, as, for example, contracting parties or mutual consent; or that a contract was actually entered into, but is not legally enforceable by either party by reason of some rule of law, such as the statute prohibiting usurious contracts, or the common law rule against immoral contracts or contracts without a consideration and not under seal. A contract is generally said to be "voidable," if the essential elements of a contract are present, but one of the parties is entitled, by reason of some rule of law, to withdraw from the agreement. Contracts made by infants, or induced by the fraud of either of the parties, are of this description. It is evident that a contract made by an agent in violation of his duty is not *voidable* in the sense here indicated. The reason why the principal is not bound, if his agent attempts to contract with himself, or for his own benefit, is that authority to make such a contract was not delegated to the agent. An essential element of a contract, the consent of the parties, is therefore wanting, and no contract is in fact created. But it does not necessarily follow that the agent may refuse to be bound, if the principal should give his consent afterwards by adopting the pretended contract. It has always been held that the principal may ratify an unauthorized attempt to form a

116; *Gardner v. Butler*, 30 N. J. Eq. 702; *Wardell v. Union Pacific R. R. Co.*, 103 U. S. 651; 4 Dill. 330; *Coleman v. Second Ave. R. R. Co.*, 38 N. Y. 201; *Wilbur v. Lynde*, 49 Cal. 290; and see cases *supra*, § 517.

¹ See *Twin Lick Oil Co. v. Marbury*, 91 U. S. 587; *Ashhurst's Ap-*

peal, 60 Pa. St. 291; *Little Rock, &c. Ry. Co. v. Page*, 35 Ark. 304; *Buell v. Buckingham*, 16 Iowa, 284; *Kitchen v. St. Louis, &c. Ry. Co.*, 69 Mo. 224; *Stewart v. Lehigh Valley R. R. Co.*, 38 N. J. Law, 522. Compare *Gardner v. Butler*, 30 N. J. Eq. 702. *Infra*, § 526.

contract on his behalf, and thereby give the transaction the same effect as if a contract had been formed originally. If an agent attempts to contract with himself, or for his own benefit, the principal has always the privilege of adopting the transaction. He may either ratify it entirely, or, at his option, may allow the transaction to stand at law, and hold the agent liable in equity, as trustee, to account for the profits obtained through the violation of his fiduciary obligations.¹

In applying these general doctrines to the unauthorized attempts of directors of a corporation to bind the corporation for their own benefit, it should be borne in mind that the corporation cannot, as a rule, act except through its managing agents. It would generally be the duty of the directors themselves either to adopt or repudiate the unauthorized transactions on behalf of the corporation, as its interests may require. The directors certainly cannot complain if they are held liable according to their own professions, and on their obligations to the corporation.

§ 525. **Remedies of the Corporation.** — The corporation would be entitled to recover damages for any injuries caused by unauthorized acts of this description.² If the unauthorized acts are merely threatened, a preventive remedy by injunction may usually be obtained by the corporation, or by its shareholders, if the company's agents refuse to act.³

The corporation may, however, ratify an unauthorized transaction of its agents; and this may be done either by the unanimous acquiescence of the shareholders, or by vote of the majority, if the transaction is of such a character that the majority might have authorized it at the outset.⁴

¹ *Supra*, § 516 *et seq.* If the corporation does not disaffirm the transaction, or take proceedings to set it aside, it should, as a rule, be treated as binding, if called in question by other parties. *Buell v. Buckingham*, 16 Iowa, 284.

² *Shultz v. Christman*, 6 Mo. App. 338, 342.

³ *Supra*, § 254. *Gray v. New York, &c. Steamship Co.*, 3 Hun, 383.

⁴ *Hotel Co. v. Wade*, 97 U. S. 13; *Twin Lick Oil Co. v. Marbury*, 91 U. S. 587; *Buell v. Buckingham*, 16 Iowa, 284, 295; *First Nat. Bank v. Reed*, 36 Mich. 263; *U. S. Rolling Stock Co. v. Atlantic, &c. R. R.*

If an agent of a corporation has applied corporate funds to his own use, he may be compelled to account for these funds in equity as trustee; and so if an agent obtains a profit to himself through an unauthorized dealing with the company, the corporation may treat the transaction as binding at law, and charge the agent as trustee of the profits received.¹

§ 526. **Obligation of the Company to pay for the Value received under a pretended Contract with its Agents.**— If the directors or other agents of a corporation supply it with money or property, under a pretended contract with themselves, and the money or property is properly used in carrying on the company's business, or in adding to its assets, they are entitled to recover the value of the money or property so supplied and used, in an action against the company. The obligation of the company to pay under these circumstances does not rest upon any actual contract with the directors, but is a duty which the law imposes, for reasons of justice, to make fair compensation for what has been properly received and applied. The same rule applies where the directors perform services for the company which are outside of the duties of their office.²

§ 527. **A Director or Agent may deal with the Corporation if the latter is represented by other Agents.**— The incapacity of

Co., 34 Ohio St. 463; *Kitchen v. St. Louis, &c. Ry. Co.*, 69 Mo. 224; and see *infra*, § 625.

¹ *York, &c. Ry. Co. v. Hudson*, 16 Beav. 485; *Gaskell v. Chambers*, 26 Beav. 360; *Madrid Bank v. Pelly*, L. R. 7 Eq. 442; *Parker v. McKenna*, L. R. 10 Ch. 96; *Bent v. Priest*, 10 Mo. App. 543; *Gilman, &c. R. R. Co. v. Kelley*, 77 Ill. 426; *Blair Town Lot, &c. Co. v. Walker*, 50 Iowa, 376; and see the following section.

² *Gardner v. Butler*, 30 N. J. Eq. 702, 721, 724; and see *infra*, § 715 *et seq.* In *Gardner v. Butler*, Van Syckel, J., said: "The rule is, that the trustee cannot fortify himself

by a contract which he makes with himself, or for his own benefit, and set it up, either at law or in equity, as a valid obligation. . . . But while the express undertaking is without legal force, the directors of a company have a right to serve it in the capacity of officers, agents, or employees, and for such services the law will enable them to recover a just and reasonable compensation. . . . No claim which they may make against their company can acquire any support or validity from the fact that they have expressly sanctioned it; it must rest exclusively upon its fairness and justice, and be enforced upon the *quantum meruit*."

the agents of a corporation to bind it by making contracts with themselves personally, rests solely on the principles of the law of agency. There is no arbitrary rule of law prohibiting contracts between a corporation and its agents, where these principles have no application. Thus, if an agent does not assume to represent the corporation in entering into a contract with it, but deals with another independent agent, who has authority to act for it, the transaction will be unobjectionable. An agent may even represent the corporation in executing a contract with himself personally, provided he acts under immediate instructions from some other superior agent or from the board of directors.¹

It has been held in some cases, that a director cannot enter into a valid contract with the corporation of which he is agent, although the corporation is represented in the transaction by a majority of the board. This view is placed upon the ground that each director owes the corporation the full benefit of his judgment and skill, and is bound to assist the other directors in their deliberations.²

But the weight of authority and of reason appears to indicate that such a contract would be valid.³ It is never necessary that all the directors should take part in the deliberations of the board. The general rule is, that a majority of the board constitute a quorum for the transaction of business, and that a majority of those who attend a meeting, at which a quorum are present, have authority to bind the corporation by their vote.⁴ There is no necessary impropriety in a contract between a director and the corporation, if the latter is

¹ *Bradley v. Richardson*, 23 Vt. 720; *Addison v. Lewis*, 75 Va. 701; *Stratton v. Allen*, 16 N. J. Eq. 229.

² *Aberdeen Ry. Co. v. Blakie*, 1 Macq. Sc. App. 461, 473, *per Lord Campbell*, in the House of Lords; *Stewart v. Lehigh Valley R. R. Co.*, 38 N. J. Law, 523.

³ *U. S. Rolling Stock Co. v. Atlantic, &c. R. R. Co.*, 34 Ohio St. 450; *Duncomb v. New York, &c.*

R. R. Co., 88 N. Y. 1; *Harts v. Brown*, 77 Ill. 226; *Twin Lick Oil Co. v. Marbury*, 91 U. 587, 588; *Kitchen v. St. Louis, &c. Ry. Co.*, 69 Mo. 224; *Chouteau v. Allen*, 70 Mo. 338; *Barnes v. Trenton Gas Light Co.*, 27 N. J. Eq. 33, 37; *Combination Trust Co. v. Weed*, 2 Fed. Rep. 24; *Hubbard v. New York, &c. Investment Co.*, 14 Fed. Rep. 675.

⁴ *Infra*, § 531.

represented by other agents. On the contrary, such contracts are, in many instances, the natural result of circumstances, and are justified by the approved usages of business men. The directors of a corporation are generally selected by reason of their influence or wealth, and because they are interested in the success of the company, and familiar with its affairs. Not infrequently, persons who agree to advance money to the corporation expressly stipulate for a voice in the board of directors, so that they may be able to supervise the faithful application of the money advanced, and keep watch for their own security. To prohibit the directors, in all cases, from dealing with the corporation, would often deprive the latter, in time of need, of the assistance of those persons who have the greatest interest in its welfare, and who are willing to give their aid upon the most reasonable terms.¹

But a transaction between a director and the corporation, even if the latter was represented by a majority of the board, will always be scrutinized by the courts with strictness, and will be set aside at the suit of the corporation, upon proof of the slightest unfairness or imposition practised upon it. A director will not be allowed to obtain any advantage over the corporation of which he is agent, through his position, or the information which he has obtained of the affairs of the corporation, or his influence over his co-directors.²

§ 528. **Directors or Agents cannot represent both Parties in making a Contract.**—A person who is agent for two parties cannot, in the absence of express authority from each, represent them both in a transaction in which they have contrary interests. This rule is based upon the same reason as the rule which prohibits an agent from representing his principal, when his personal interests are opposed to his duty. The principal stipulates for the judgment and skill of his agent, and the latter has no authority to act, when he is not in a position to give the principal the benefit of his best endeavor.

¹ Compare *Kitchen v. St. Louis, &c. Ry. Co.*, 69 Mo. 224. 450; *Twin Lick Oil Co. v. Marbury*, 91 U. S. 587; *Combination Trust*

² *U. S. Rolling Stock Co. v. Atlantic, &c. R. R. Co.*, 34 Ohio St. Co. v. Weed, 2 Fed. Rep. 24.

ors. It follows, therefore, that the directors, or other agents of a corporation, have no implied authority to bind the company by making a contract with another corporation which they also represent. Each company would be interested in obtaining an advantageous bargain at the expense of the other company, and each would have a claim upon the best endeavors of its agents, unbiased by favor to others.

It has been held, upon this principle, that a person acting as agent for two insurance companies cannot execute a contract of reinsurance on behalf of one company in favor of the other.¹

§ 529. **Directors cannot favor the Majority at the Expense of a Minority.** — It is well settled, that, if the same persons are appointed to act as directors of different companies, they have no authority to represent both companies in transactions in which their interests are opposed. It matters not that the acts of the directors are in the interest of a majority of the shareholders in each company, and have received their approval. Nothing can be more unjustifiable and dishonorable than an attempt on the part of those holding a majority of the shares in a corporation to place their nominees in control of the company, and then to use their control for the purpose of obtaining advantages to themselves at the expense of the minority; it would be a conspiracy to commit a breach of trust. The directors of a corporation are bound to administer its affairs with strict impartiality, in the interest of all the shareholders alike; and the inability of the minority to pro-

¹ *New York Central Ins. Co. v. National, &c. Ins. Co.*, 14 N. Y. 85, 91. Denio, C. J., said: "The plaintiffs were entitled to all his skill and ability, and the defendants had the like claims upon him. Neither required the services of an indifferent person; whose object might be to secure equal advantages to both the contractors. No one will contend that he, as the defendant's agent, could have made a contract to insure himself; but his duty to the plaintiffs required that he should act in their behalf with all the sagacity and discretion which a fair man would have exercised in his own business. There was, therefore, a manifest inconsistency in his attempting to negotiate this insurance as agent for the insurers and the assured." See also *Mercantile Mut. Ins. Co. v. Hope Ins. Co.*, 8 Mo. App. 408; *Utica Ins. Co. v. Toledo Ins. Co.*, 17 Barb. 132.

tect themselves against unauthorized acts performed with the connivance of the majority, renders their right to the protection of the courts the clearer.¹

The case of *Pearson v. Concord R. R. Co.*,² is a good illustration of these doctrines. Two railroad companies, whose lines connected with that of a third company, bought up a controlling interest in the stock of the latter company, and then elected a number of their own agents to its board of directors. Having thus obtained control over the management of the company, they induced the board of directors to make certain contracts in relation to the apportionment of earnings upon joint traffic of the companies, and to vote the payment of large sums of money in compromise of claims made by the two companies against the company in whose behalf the directors were acting. In a suit brought by a dissenting shareholder of that company, the Supreme Court of New Hampshire held that the company whose management was thus controlled had an absolute right to refuse to be bound by these transactions, whether the contracts and the compromise were fair or not.

§ 530. However, there is certainly no rule of law or of propriety prohibiting a person from holding office as director of different companies at the same time. Nor would the board of directors of a company be disqualified from approving of contracts with another company, merely because certain members of the board, less than a majority, are officers of both the companies. Those directors who are agents of both companies would be disqualified from representing them both in a transaction in which their interests are opposed; but the other directors would retain their power of acting by vote of a majority of a quorum, as in case of a simple absence of the disqualified members from the meetings of the board.³

¹ See *supra*, Chapter V.

Fed. Rep. 14. See also cases *supra*, §§ 249, 477.

² *Pearson v. Concord R. R. Co.*, 13 Am. & Eng. R. R. Cas. 94, 102. See also *Goodin v. Cincinnati, &c. Canal Co.*, 18 Ohio St. 169; *Booth v. Robinson*, 55 Md. 419, 442, 444; *Bill v. Western Union Tel. Co.*, 16

³ *U. S. Rolling Stock Co. v. Atlantic, &c. R. R. Co.*, 34 Ohio St. 450; *Kitchen v. St. Louis, &c. Ry. Co.*, 69 Mo. 224; *Flagg v. Manhattan Ry. Co.*, 4 Am. & Eng. R. R.

§ 531. **Directors can act only as a Board. — Meetings. —** The general rule is, that the directors of a corporation have no implied authority to act singly ; they can act only as a board, unless there be a different custom, or an express delegation of authority to act individually.¹ Either all must be present at a meeting, or the meeting must be called in a regular manner, and all the directors given notice ; and in the latter case, if a majority assemble, they may act by a major vote. A majority of the directors form a quorum, in the absence of a different regulation, and a majority of the quorum determine the action of the board. Thus, if there are nine directors, five constitute a quorum, and a resolve passed by the majority at a meeting where at least five are present is binding upon the company.²

Notice of the meetings of directors of a corporation must be given in the same manner as notice of the meetings of shareholders.³ The notice must distinctly fix the time and place of the meeting, and the notice must be given in time to enable the person notified to reach the place of meeting in the customary manner.⁴

§ 532. **Notice of Meetings necessary. —** It has been held, that, if a quorum of the directors of a corporation meet and unite in any determination, the company is bound thereby,

Cas. 141; Metropolitan Elevated Ry. Co. v. Manhattan Elevated Ry. Co., 11 Daly, 373, 380. *Supra*, § 527.

¹ Baldwin v. Canfield, 26 Minn. 43.

² Despatch Line v. Bellamy Manuf. Co., 12 N. H. 207, 225-228; Edgerly v. Emerson, 23 N. H. 555; Wells v. Rahway, &c. Rubber Co., 19 N. J. Eq. 402; Sargent v. Webster, 13 Metc. (Mass.) 497; Gordon v. Preston, 1 Watts, 385; Price v. Grand Rapids, &c. R. R. Co., 13 Ind. 58; Cowley v. Same, Id. 61; Hamilton v. Same, Id. 347; Junction R. R. Co. v. Reeve, 15 Ind. 237; Cram v. Bangor House Proprietary, 12 Me. 359; German Evangelical Congr. v. Pressler, 14 La. Ann. 811. Compare Jewett v.

Town of Alton, 7 N. H. 253; Bank of Middlebury v. Rutland, &c. R. R. Co., 30 Vt. 159; Bradstreet v. Bank of Royalton, 42 Vt. 128; State v. Smith, 48 Vt. 266; Baldwin v. Canfield, 26 Minn. 43, 54; Lockwood v. Thunder Bay, &c. Boom Co., 42 Mich. 536; Doyle v. Mizner, 42 Mich. 332. Compare also *supra*, § 475.

It is not necessary that the president of a corporation should be present at a meeting of the directors in order to enable them to transact business. Sargent v. Webster, 13 Metc. (Mass.) 497.

³ See *supra*, § 481.

⁴ Covert v. Rogers, 38 Mich. 363.

whether the other directors were notified or not.¹ But this view is certainly not correct. The shareholders in a corporation are entitled not only to the votes of the directors, but also to their influence and argument in the discussion which leads to the passage of their resolutions.² While it may not be the duty of every director to be present at every meeting of the board, yet it is certainly the intention of the shareholders that every director shall have a right to be present at every meeting, in order to acquire full information concerning the affairs of the corporation, and to give the other directors the benefit of his judgment and advice. If meetings could be held by a bare quorum, without notifying the other directors, the majority might virtually exclude the minority from all participation in the management of the company.³ If it appears that a meeting of the directors was attended by a quorum, it will be presumed, in the absence of the contrary, that due notice of the meeting was given to all the directors, and that all necessary formalities have been complied with.⁴

§ 533. **The Authority of Agents to act in Foreign States.** — **Place of Meeting of Directors.** — It is well settled that a corporation has implied authority to carry on its legitimate business in foreign States, unless expressly prohibited from doing so by the terms of its charter. The ordinary managing agents of a corporation are impliedly authorized to represent it abroad, as well as at home.⁵

It has been doubted whether the board of directors of a corporation may hold their meetings outside of the territory

¹ See *per* Bell, J., in *Edgerly v. Emerson*, 23 N. H. 555, 569; *Bank v. Flour Co.*, 41 Ohio St. 552, 559.

² *Per* Grover, J., in *Ogden v. Murray*, 39 N. Y. 207.

³ *Kersey Oil Co. v. Oil Creek, &c. R. R. Co.*, 12 Phila. 374; *Doyle v. Mizner*, 42 Mich. 332; *Herrington v. Liston*, 47 Iowa, 11; *Stoystown, &c. Turnp. Co. v. Craver*, 45 Pa. St. 386; *Corn Exch. Bank v. Cumberland Coal Co.*, 1 Bosw. 436;

Cammeyer v. United German, &c. Churches, 2 Sandf. Ch. 187; *Schumm v. Seymour*, 24 N. J. Eq. 153; *Dey v. Jersey City*, 19 N. J. Eq. 412; *D'Arcy v. Tamar, &c. Ry. Co.*, L. R. 2 Ex. 158. Compare *Re Bonelli's Tel. Co.*, L. R. 12 Eq. 246, 259.

⁴ *Chouteau Ins. Co. v. Holmes*, 68 Mo. 601.

⁵ *Supra*, § 359.

of the State by which the company was chartered; but the weight of authority seems to be in favor of the view that the directors may hold their meetings and transact business wherever they deem this to be desirable, unless the contrary is expressly prescribed by the company's charter or by-laws;¹ every director must, however, be given a fair opportunity to be present.

§ 534. **Delegation of Authority. — The Appointment of Committees and Inferior Agents.** — The authority of an agent to represent his principal is, in the nature of things, not transferable without the consent of the principal himself. This rule applies with full force to the agents of a corporation.²

It is to be observed, however, that authority in an agent to appoint inferior agents with power to represent the principal may in many cases be implied. Thus, the directors of a corporation have a general authority to manage the company's business in the customary manner; and this usually necessitates the appointment of various inferior agents to take charge of the details of the company's business. The directors of a corporation have implied authority to appoint all such agents, of the usual character, as may be required for the purpose of carrying on the company's business advantageously and conveniently.³ The directors of a bank may

¹ *McCall v. Byram Manuf. Co.*, 6 Conn. 428; *Wright v. Bundy*, 11 Ind. 404; *Smith v. Alvord*, 63 Barb. 415; *Bellows v. Todd*, 39 Iowa, 209; *Ohio, &c. R. R. Co. v. McPherson*, 35 Mo. 13; *Arms v. Conant*, 36 Vt. 745; *Corbett v. Woodward*, 5 Sawy. 403; *Bassett v. Monte Christo Mining Co.*, 15 Nev. 293; *Reichwald v. Commercial Hotel Co.*, 106 Ill. 439; *Galveston R. R. Co. v. Cowdrey*, 11 Wall. 477. Compare *Hilles v. Parrish*, 1 McCarter, 380; *Ormsby v. Vermont Copper Mining Co.*, 56 N. Y. 623.

In *Wood Hydraulic, &c. Mining Co. v. King*, 45 Ga. 40, *McCay, J.*, said: "The authorities are now uniform, that an agent of a corporation

may exercise its powers out of the State incorporating it, provided there be nothing in the charter or in the nature of its powers contravening it. If one agent may thus act, there would seem to be no sensible reason why a board of agents may not do so. As directors are only agents, the principle is broad enough to include them."

The general rule is, that meetings of the shareholders must be held within the State which chartered the company. *Supra*, § 488.

² See cases cited in the following notes.

³ *Hoyt v. Thompson*, 19 N. Y. 207, 216; *Kitchen v. Cape Girardeau, &c. R. R. Co.*, 59 Mo. 514; *Burrill*

authorize the president, or president and cashier, to borrow money, and to draw and indorse negotiable paper in the name of the corporation.¹ The board of directors of a bank may also delegate to a committee of their own members authority to mortgage and sell real estate belonging to the company.² The directors of a land company may invest an agent with authority to draw bills of exchange.³

Agents appointed by the directors of a corporation to assist in carrying on its business are agents of the corporation, and not of the directors themselves. Hence the authority of such agents does not necessarily cease upon the termination of the authority of the directors who appointed them.⁴

§ 535. **Delegation of Discretionary Powers.**—It has sometimes been laid down as a rule, that powers involving the exercise of discretion and judgment cannot be delegated except under an express grant of authority;⁵ but this statement of the rule is not strictly accurate. The authority of an agent to delegate powers to another agent depends always upon the intention of the principal. The appointment of an agent with powers requiring the exercise of judgment and discretion is in many cases an indication that the principal intended the judgment and discretion to be exercised by the particular agent whom he selected; but this is not always so. Thus, the directors of a corporation have, undoubtedly, implied au-

v. Nahant Bank, 2 Metc. (Mass.) 163, 167; *Western Bank of Missouri v. Gilstrap*, 45 Mo. 419.

¹ *Ridgway v. Farmers' Bank*, 12 S. & R. 256; *Fleckner v. U. S. Bank*, 8 Wheat. 338, 356; *Spear v. Ladd*, 11 Mass. 94; *Northampton Bank v. Pepon*, 11 Mass. 288; *Merrick v. Bank of Metropolis*, 8 Gill, 59. Compare *Bank Commissioners v. Bank of Buffalo*, 6 Paige, 497; *Olcott v. Tioga R. R. Co.*, 27 N. Y. 546. In *State v. Glenn*, 18 Nev. 34, it was held that the directors of a land company could authorize the president to donate land to a county.

² *Burrill v. Nahant Bank*, 2 Metc. (Mass.) 163, 167; *Hoyt v. Thompson*, 19 N. Y. 207; *Mitchell v. Deeds*, 49 Ill. 418; *Augusta Bank v. Hamblet*, 35 Me. 491. Compare *Gillis v. Bailey*, 21 N. H. 149.

³ *Preston v. Missouri, &c. Lead Co.*, 51 Mo. 43.

⁴ *Anderson v. Longden*, 1 Wheat. 85; *Exeter Bank v. Rogers*, 7 N. H. 33; *Dedham Bank v. Chickering*, 3 Pick. 335.

⁵ *Gillis v. Bailey*, 21 N. H. 149, 161-165; *Silver Hook Road v. Greene*, 12 R. I. 164; *Farmers', &c. Ins. Co. v. Chase*, 56 N. H. 341.

thority to appoint various agents, the performance of whose duties involves the exercise of a high degree of judgment and discretionary power. Directors of a railroad company may, without express authority, appoint engineers, superintendents, freight and passenger agents, and any other officers that may be required for the proper construction and management of the railroad. The directors of banking, insurance, and commercial corporations have implied authority to employ financial agents. The employment of attorneys to manage the legal affairs of a corporation, and to institute or defend suits, is clearly within the implied authority of the directors or general managing agents.¹

The board of directors have also implied authority to appoint a committee of their number with authority to execute the resolutions of the board, and to exercise general control over the affairs of the corporation during the recess of the board. The extent of the powers which may thus be conferred by the board of directors upon a committee depends upon the character of the corporation, the frequency with which the board is required to meet, the nature of its duties, and upon established custom. No more definite rule can be formulated.²

§ 536. **When Authority cannot be Delegated.**—However, the authority of the directors of a corporation to appoint inferior agents with power to represent the company can be implied only where such appointment would be a reasonable measure in carrying on the company's business in the ordinary manner. Those powers of the directors of a corporation

¹ *Western Bank v. Gilstrap*, 45 Mo. 419; *American Ins. Co. v. Oakley*, 9 Paige, 496; *Southgate v. Atlantic, &c. R. R. Co.*, 61 Mo. 89; *Bristol County Savings Bank v. Keavy*, 128 Mass. 298; *Thompson v. School District*, 71 Mo. 495; *Davis v. Memphis City Ry. Co.*, 22 Fed. Rep. 883. See, however, *Citizens' Bank v. Keim*, 10 Phila. 311; *Maupin v. Virginia Lead Mining Co.*, 78 Mo. 24. The answer

of a corporation must be verified and filed by those persons who are officers of the corporation at the time when the answer is filed. *Mechanics' Nat. Bank v. Burnet Manuf. Co.*, 32 N. J. Eq. 236.

² See *Hoyt v. Thompson*, 19 N. Y. 207, 215; and cases *supra*, § 534. Compare *Taylor v. Agricultural, &c. Ass.*, 68 Ala. 229; *Tracy v. Guthrie County Agr. Society*, 47 Iowa, 27.

which it is intended they should exercise personally, can in no case be delegated.

The general supervision and direction of the affairs of a corporation are especially intrusted by the shareholders to the board of directors; it is upon the personal care and attention of the directors that the shareholders depend for the success of their enterprise. It follows that authority to delegate these general powers of management cannot be implied. Thus, the directors of a company have no implied authority to enter into a contract with a creditor, by which the entire management of the company's affairs is placed in his control until the debt has been paid.¹

Upon the same principle, it has been held that the board of directors of a colliery company cannot delegate a discretionary power of allotting shares to two members of the board and the manager.²

The directors of a corporation have no implied authority to delegate to other agents the power of making calls,³ or of declaring dividends;⁴ and it has been held that they cannot give an inferior agent the power of selling shares for non-payment of calls, if this power is intrusted by the charter to their own discretion.⁵

§ 537. **The Powers of the President of a Corporation.** — The implied powers of the president of a corporation depend upon the nature of the company's business, and the measure of authority delegated to him by the board of directors. It seems that a president has no greater powers, by virtue of his office merely, than any other director of the company, except that

¹ *Davis v. Flagstaff Mining Co.*, 2 Utah, 74; *Flagstaff Mining Co. v. Patrick*, 2 Utah, 304.

There would be no objection to a transfer of the control over the corporate affairs, if all the stockholders give their consent. *Lorillard v. Clyde*, 86 N. Y. 384.

² *Howard's Case*, L. R. 1 Ch. 561, 563. Shares may, however, be issued by deputy, if the allotment does not involve the exercise of a

discretion intrusted to the directors alone. *Lohman v. New York, &c. R. R. Co.*, 2 Sandf. 39.

³ *Silver Hook Road v. Greene*, 12 R. I. 164; *Farmers', &c. Ins. Co. v. Chase*, 56 N. H. 341. Compare *Read v. Memphis, &c. Gas Co.*, 9 Heisk. 545. *Supra*, § 145.

⁴ *Gratz v. Redd*, 4 B. Monr. 186.

⁵ *York, &c. R. R. Co. v. Ritchie*, 40 Me. 425. *Supra*, § 123.

he is the presiding officer at the meetings of the board.¹ The Supreme Court of New Jersey said: "In the absence of anything in the act of incorporation bestowing special power upon the president, he has, from his mere official station, no more control over the corporate property and funds than any other director. The affairs of corporate bodies are within the exclusive control of their boards of directors, from whom authority to dispose of their assets must be derived."²

In *Walworth County Bank v. Farmers' Loan, &c. Co.*,³ Cole, J., delivering the opinion of the court, said: "It is contended that Durand, by virtue of his office as president of the railroad company, was fully authorized and empowered to sell and dispose of any of the personal property of the company in payment of its debts. We are unable to say what are the precise powers and duties of the president of a railroad company over its property and concerns; but we do not think he can, by virtue of the power inherent in his office, dispose of the personal property of the corporation for any purpose at his pleasure, without special authority from the board of directors. If so, we cannot see why he might not dispose of the entire rolling stock of the company, if he saw fit. It is probable that the general custom is for the board of directors to clothe the president of the road with extensive authority over its management and concerns; but the fact that this power is conferred either by some article in the by-laws, or by a resolution of the board, shows conclusively that it is not inseparable from the office."

§ 538. However, the presidents of corporations, by general custom, exercise much wider powers than those accorded to

¹ *Chicago, &c. Ry. Co. v. James*, 22 Wis. 198.

² *Titus v. Cairo, &c. R. R. Co.*, 37 N. J. Law, 98, 102, *per* Van Syckel, J. See also *Westerfield v. Radde*, 7 Daly, 326; *McCullough v. Moss*, 5 Denio, 567. Compare, however, *Stokes v. New Jersey Pottery Co.*, 46 N. J. Law, 237.

³ *Walworth County Bank v. Farmers' Loan, &c. Co.*, 14 Wis. 325,

329. See also *Fulton Bank v. New York, &c. Canal Co.*, 4 Paige, 134, 135; *Bliss v. Kaweah Canal, &c. Co.*, 65 Cal. 502; *Hodge v. First Nat. Bank*, 22 Gratt. 51; *Union Gold Mining Co. v. Rocky Mt. Nat. Bank*, 2 Col. 565.

As to the powers of the president of a bank, see *Hodge v. First Nat. Bank*, 22 Gratt. 58; *First Nat. Bank v. Kimberlands*, 16 W. Va. 555, 578.

them by the authorities cited in the preceding section; and this custom has been judicially recognized. In *Smith v. Smith*, the Supreme Court of Illinois said: "In the absence of legislative enactment or provision made in the by-laws, corporations usually act through their president, or those representing him. He being the legal head of the body, when an act is performed by him the presumption will be indulged that the act is legally done, and is binding upon the body; and, as a general rule, in the absence of the president, or where a vacancy occurs in the office, the vice-president may act in his stead, and perform the duties which devolve upon the president."¹

There can be no doubt that the board of directors may invest the president with authority to act as chief executive officer of the company. This may be done either by an express resolution, or by acquiescence in a course of dealing. A person dealing with the president of a corporation in the usual manner, and within the powers which the president has been accustomed to exercise without the dissent of the directors, would be entitled to assume that the president had actually been invested with those powers.²

§ 539. *The Powers of the Cashier of a Bank.*—The extent of the powers of a cashier of a bank was very fully considered by the Supreme Court of the United States, in *Merchants' Bank v. State Bank*.³ It was there decided that a cashier had, *virtute officii*, authority to certify checks in the usual course of banking business. Justice Swayne, delivering the opinion of the court, said: "The cashier is the

¹ *Smith v. Smith*, 62 Ill. 493, 496, *per* Justice Walker. See also *Mitchell v. Deeds*, 49 Ill. 417, 424; *Union Mut. Life Ins. Co. v. White*, 106 Ill. 67, 75; *Irwin v. Bailey*, 8 Biss. 523; *Kraft v. Freeman Printing, &c. Ass.*, 87 N. Y. 628; *Crowley v. Genesee Mining Co.*, 55 Cal. 273; *Merchants' Bank v. Goddin*, 76 Va. 503; *Reno Water Co. v. Leete*, 17 Nev. 203. Compare *Mitchell v. Vermont Copper, &c. Co.*, 67 N. Y. 280; *Twelfth Street Market Co. v. Jackson*, 102 Pa. St. 269; *Asher v. Sutton*, 31 Kans. 286; *Second Ave R. R. Co. v. Mehrbach*, 49 N. Y. Super. Ct. 267; *Castle v. Belfast Foundry Co.*, 72 Me. 167.

² *First Nat. Bank v. Kimberlands*, 16 W. Va. 555, 580. Compare *Stokes v. New Jersey Pottery Co.*, 46 N. J. Law, 237.

³ 10 Wall. 604.

executive officer, through whom the whole financial operations of the bank are conducted. He receives and pays out its moneys, collects and pays its debts, and receives and transfers its commercial securities. Tellers and other subordinate officers may be appointed, but they are under his direction, and are, as it were, the arms by which designated portions of his various functions are discharged. A teller may be clothed with the power to certify checks, but this in itself would not affect the right of the cashier to do the same thing. The directors may limit his authority as they deem proper, but this would not affect those to whom the limitation was unknown.”¹ Judge Story said: “The cashier of a bank is, *virtute officii*, generally intrusted with the notes, securities, and other funds of the bank, and is held out to the world by the bank as its general agent in the negotiation, management, and disposal of them. *Prima facie*, therefore, he must be deemed to have authority to transfer and indorse negotiable securities held by the bank, for its use and in its behalf. No special authority for this purpose is necessary to be proved.”²

§ 540. The authority of the cashier of a bank is limited to the management of the company's ordinary business. Transactions which are outside of the ordinary course of banking business must be approved by the board of directors. Thus, in *United States v. City Bank of Columbus*,³ the Supreme

¹ *Merchants' Bank v. State Bank*, 10 Wall. 604, 650. See also *West St. Louis Sav. Bank v. Shawnee County Bank*, 95 U. S. 559; 3 Dill. 403; *Martin v. Webb*, 110 U. S. 7; *City Bank v. Perkins*, 29 N. Y. 554; *Caldwell v. National Mohawk Valley Bank*, 64 Barb. 333; *Yerkes v. Nat. Bank of Port Jervis*, 69 N. Y. 383; *Coats v. Donnell*, 94 N. Y. 168; *Chemical Nat. Bank v. Kohner*, 8 Daly, 530, 533, 534; *Matthews v. Mass. Nat. Bank*, 1 Holmes, 396; *Cochecho Nat. Bank v. Haskell*, 51 N. H. 121; *Bissell v. First Nat.*

Bank, 69 Pa. St. 415; *Badger v. Bank of Cumberland*, 26 Me. 428; *Ryan v. Dunlap*, 17 Ill. 40; *Robinson v. Bealle*, 20 Ga. 275.

The cashier may borrow money. *Donnell v. Lewis County Savings Bank*, 80 Mo. 165.

² *Wild v. Bank of Passamaquoddy*, 3 Mason, 506.

The cashier of a bank may warrant the collectibility of a bill of exchange. *Sturges v. Bank of Circleville*, 11 Ohio St. 153.

³ *United States v. City Bank of Columbus*, 21 How. 356.

Court held that the cashier of a bank had no implied authority to authorize an individual director to enter into a contract with the Secretary of the Treasury to transport money of the United States free of charge. Justice Wayne, delivering the opinion of the court, said: "In *Bank of the United States v. Dunn* (6 Peters, 51), the court would not permit the president and cashier of the bank to bind it by their agreement with the indorser of a promissory note, that he should not be liable on his indorsement.¹ It is said it is not the duty of the cashier and president to make such contracts, nor have they power to bind the bank, except in the discharge of their ordinary duties. All discounts are made under the authority of the directors, and it is for them to fix any conditions which they may think proper in loaning money. The court defines the cashier of the bank to be an executive officer, by whom its debts are received and paid, and its securities taken and transferred, and that his acts, to be binding upon a bank, must be done within the ordinary course of his duties. . . . The term 'ordinary business,' with direct reference to the duties of cashiers of banks, occurs frequently in English cases, and in the reports of decisions of our State courts, and in no one of them has it been judicially allowed to comprehend a contract made by a cashier, without an express delegation of power from a board of directors to do so, which involves the payment of money, unless it be such as has been loaned in the usual and customary way. Nor has it ever been decided that a cashier could purchase or sell the property, or create an agency of any kind for a bank, which he had not been authorized to make by those to whom has been confided the power to manage its business, both ordinary and extraordinary."²

It has been held that the cashier of a bank has no implied authority to certify a post-dated check,² or to pledge the

¹ See also *Cochecho Nat. Bank v. Chester*, 14 Miss. 218, 234-238; *Haskell*, 51 N. H. 116, 121; *Hodge Mapes v. Second Nat. Bank*, 80 Pa. v. *First Nat. Bank*, 22 Gratt. 51. St. 163; *Lamb v. Cecil*, 25 W. Va. 288.

² *United States v. City Bank of Columbus*, 21 How. 356, 364. See ³ *Clarke Nat. Bank v. Bank of State v. Commercial Bank of Man- Albion*, 52 Barb. 592.

assets of the bank for the payment of an antecedent debt,¹ or to settle an account in another State by receiving unsecured notes of individuals in payment,² or to compromise claims due the bank.³

In those States where the receipt of special deposits is considered outside of the regular course of the banking business, it is evident that a cashier would have no authority to receive special deposits.⁴ But a different rule applies where the receipt of special deposits is deemed incidental to the banking business, or is authorized by an express delegation of authority.⁵

§ 540 a. **When Evidence of an Admission or Statement made by an Agent is admissible.**—The general rule is that evidence of hearsay is inadmissible; a fact to be proven by a party to a judicial proceeding cannot be established by showing that a person other than the opposing party, or a party in interest, made a statement regarding the existence of that fact. There are, however, several distinct grounds upon which evidence of statements made by an agent may be admissible as against the principal.

First, if the principal authorized his agent to make a statement on his behalf, the statement may be shown against the principal as an admission.⁶ Thus, in an action against a railroad company, brought by a passenger for the loss of his baggage, the admissions of the conductor, baggage-master, and station-agent, made in answer to inquiries of the passenger on the morning after the loss, were held provable against the company, because these agents had authority, under the circumstances, to make the statements on behalf of the company. Bigelow, J., said: "It was a part of the duty of those agents to deliver the baggage of passengers, and to account for the same, if missing, provided inquiries for it were

¹ *State v. Davis*, 50 How. Pr. Vt. 546; *Whitney v. First Nat. Bank*, 50 Vt. 388.

² *Sandy River Bank v. Merchants' &c. Bank*, 1 Biss. 146.

³ *Chemical Nat. Bank v. Kohner*, 8 Daly, 530.

⁴ *Wiley v. First Nat. Bank*, 47

⁵ *Supra*, § 388. *Pattison v. Syracuse Nat. Bank*, 80 N. Y. 82, and cases cited; *National Bank v. Graham*, 100 U. S. 699.

⁶ See Stephen on Evid., art. 17.

made within a reasonable time. These declarations were therefore made by them as agents of the defendant, within the scope of their agency and while it continued.”¹ It should be observed, that a statement made by an agent is admissible against the principal *as an admission* only provided the agent had actual authority, as between himself and the principal, to make the statement. There is no principle of estoppel in a case of this kind, by which the powers of an agent can be extended beyond the authority actually conferred upon him. It follows, that a naked statement made by an agent that his principal has incurred a liability cannot, as a rule, be proven against the principal as an admission of the liability; for an agent would ordinarily have no authority to make such an admission on behalf of the principal.² A statement of this character is ordinarily admissible in evidence against the prin-

¹ *Morse v. Connecticut River R. R. Co.*, 6 Gray, 450. To the same effect, see *Lane v. Boston, &c. R. R. Co.*, 112 Mass. 455; *McGenness v. Adriatic Mills*, 116 Mass. 177; *Webb v. Smith*, 6 Col. 365; *Kirkstall Brewery Co. v. Furness Ry. Co.*, L. R. 9 Q. B. 468.

In *Holden v. Hoyt*, 134 Mass. 181, the Supreme Court of Massachusetts said: “We have no doubt that the books and records of a corporation are *prima facie* evidence against it, as admissions, and under some circumstances may be conclusive evidence. But, at most, a corporation can only be bound conclusively by its records, either when they are the records, duly made by the recording officer, of its proceedings, or when some person who has had proper access to them, or knowledge of them, has become aware of their contents, and has acted on the faith that they were the records of its proceedings.”

² See *Kalamazoo Novelty Manuf. Co. v. McAlister*, 36 Mich. 327;

Henry v. Northern Bank, 63 Ala. 527; *Hall v. Mobile, &c. Ry. Co.*, 58 Ala. 10; *East River Bank v. Hoyt*, 41 Barb. 441; *Hanover Water Co. v. Ashland Iron Co.*, 84 Pa. St. 279; *Sweatland v. Illinois, &c. Tel. Co.*, 27 Iowa, 433, 458; *Ashmore v. Pennsylvania Steam Towing, &c. Co.*, 38 N. J. Law, 13; *Grayville, &c. R. R. Co. v. Burns*, 92 Ill. 302; *Tripp v. New Metallic Packing Co.*, 137 Mass. 499; *Stiles v. Western R. R. Co.*, 8 Metc. (Mass.) 44. Compare *Malecek v. Tower Grove, &c. Ry. Co.*, 57 Mo. 17.

In *Peek v. Detroit Novelty Works*, 29 Mich. 313, *Graves, C. J.*, said: “The declarations or statements of individual directors when the board was not in session, and when such declarations or admissions did not accompany any official act, were clearly incompetent; and the statements made in discussion while the board was in session were not negotiations between the company and the plaintiff.”

cipal, to prove a fact to which it relates, only if it was made by the agent in the course of a transaction within the scope of his duties; under these circumstances, it may be proven as part of the *res gestæ*, and not strictly as an admission.

Secondly. If statements made by an agent, or any other person, constitute part of a transaction which is in issue between parties, such statements may be proven as part of the transaction. This doctrine has been stated by an English writer as follows: "The result of the cases appears to be, that if it is shown that an admission has been made by an agent acting in a matter within the scope of his authority, and that it is a part of the *res gestæ*, and does not relate to bygone transactions, then such admission is receivable in evidence against the principal, and the agent himself need not be called."¹

Thirdly. If the fact that an agent or other person made a certain statement is in issue between parties, such statement may be proven like any other fact. Thus, in an action to charge a principal with a false representation made by his agent, the making of the representation may clearly be proven by any person who heard it. So, where an attempt is made to charge a principal with a contract liability or an estoppel by reason of statements made by an agent, evidence of such statements must undoubtedly be introduced.²

§ 540 b. **When Notice to an Agent binds the Corporation.**— In order to charge a corporation with notice of a fact, the notice must be given through one of the corporate agents, for these alone have authority to represent the whole company; notice to the individual shareholders is not binding upon the company as a collective body.³ The doctrine that notice to an agent of a corporation binds the corporation is a branch of the law of agency applicable to individuals as well as to

¹ Evans on Agency, 155; Imboden v. Etowah, &c. Mining Co., 70 Ga. 86; Coyle v. Baltimore, &c. R. R. Co., 11 W. Va. 94.

Co. v. Betsworth, 30 Conn. 380; Morris, &c. R. R. Co. v. Green, 15 N. J. Eq. 469; National Exchange Co. v. Drew, 2 Macq. Sc. App. 103.

² Northrup v. Mississippi Valley Ins. Co., 47 Mo. 435; Toll Bridge

³ *Supra*, § 234.

corporations, and the same rules and principles govern its application in both instances.¹

Knowledge casually acquired by an agent must be distinguished from a notice given, with the design of notifying the principal, to an agent who has authority to receive the notice on behalf of the principal. Knowledge casually acquired by an agent affects the principal with notice only in those transactions in which that agent acts for him; but a notice expressly given to an agent, within the scope of his authority, binds the principal as fully as if it were given to the principal directly, whether the agent has communicated the notice or not. Thus, notice given to the president, cashier, or board of directors of a bank, for the purpose of charging the bank with notice of equities affecting the validity of a negotiable note, subsequently purchased or discounted by the bank, will affect the bank with notice of these equities, although the officers who received the notice failed to communicate it, and took no part in the transaction in which the note was received.²

It may be stated as a general rule, that notice given to an agent of a corporation in relation to any matter within the scope of the agent's functions operates as notice to the company; notice served upon a head officer or managing agent may therefore usually be regarded as served upon the corporation itself.³ However, if the notice does not relate to any

¹ The cases upon this subject are collected in a note to the case of *Bank of Pittsburgh v. Whitehead*, 36 Am. Dec. 186, 188-200. See also an article entitled "Notice to Directors of Corporations," 6 So. L. Rev. n. s. 45; *Waynesville Nat. Bank v. Irons*, 8 Fed. Rep. 1, and notes.

² *New Hope, &c. Bridge Co. v. Phenix Bank*, 3 N. Y. 166; *Trenton Banking Co. v. Woodruff*, 1 Green Ch. 117; *Porter v. Bank of Rutland*, 19 Vt. 410; *Bank of Pittsburgh v. Whitehead*, 10 Watts, 397; s. c. 36 Am. Dec. 186; *Fulton Bank v. New York, &c. Canal Co.*, 4 Paige Ch.

127. Compare *Bank of Virginia v. Craig*, 6 Leigh, 399.

³ *Port Jervis v. First Nat. Bank*, 96 N. Y. 550; *Olcott v. Tioga R. R. Co.*, 27 N. Y. 546; *Smith v. Board of Water Comm.*, 38 Conn. 208; *New England Car Spring Co. v. Union India Rubber Co.*, 4 Blatchf. 1; *Quincy Coal Co. v. Hood*, 77 Ill. 68; *Mechanics' Bank v. Schaumburg*, 38 Mo. 228.

Notice given in good faith to a single member of the board of directors is sufficient. *Bank of United States v. Davis*, 2 Hill, 451.

A valid notice given to an officer of a corporation is not affected by a

matter within the scope of the duties or functions of the agent to whom it is given, it will not bind the corporation unless it was afterwards communicated to the managing agents, because the agent to whom the notice was given would have no authority to receive it on behalf of the corporation. Thus, notice of the dishonor of a bill or note given to the porter of a bank would not be notice to the bank, and notice of stoppage *in transitu* of goods shipped through a railroad company would not bind the railroad company if served upon a brakeman or switchman.¹

§ 540 c. **When the Knowledge of an Agent affects the Corporation.** — When an agent performs an act on behalf of his principal, the latter by a legal fiction is regarded as the party performing the act; and by a similar fiction the principal is regarded as having any knowledge possessed by the agent which would affect the validity of the act if the agent were acting for himself. In other words, the knowledge of an agent binds the principal to the same extent as if it were the knowledge of the principal, in any transaction in which the agent represents the principal; and it is immaterial when or how the knowledge of the agent was acquired.²

A bank is therefore bound by the knowledge of any director who takes part in the discount of a note presented to the bank for discount, as to equities affecting the liability of the maker of the note.³

However, knowledge of a fact casually acquired by an agent does not affect the principal with notice of the fact,

subsequent change of officers. *Mechanics' Bank v. Seton*, 1 Pet. 309; *Fulton Bank v. New York, &c. Canal Co.*, 4 Paige Ch. 127.

¹ *Congar v. Chicago, &c. Ry. Co.*, 24 Wis. 157; *Bank of Virginia v. Craig*, 6 Leigh, 399; *Goodloe v. Godley*, 21 Miss. 233.

² *Holden v. New York, &c. Bank*, 72 N. Y. 286; *Union Bank v. Campbell*, 4 Humph. 394; *Waynesville Nat. Bank v. Irons*, 8 Fed. Rep. 1; *Hart v. Farmers', &c. Bank*, 33 Vt.

252; *Mihills Manuf. Co. v. Camp*, 49 Wis. 130. Compare *Terrell v. Branch Bank*, 12 Ala. 502; *Houseman v. Girard Mut. Building, &c. Ass.*, 81 Pa. St. 256.

³ *Bank of United States v. Davis*, 2 Hill, 451; *Myers v. Ross*, 3 Head (Tenn.), 59, 62; *Nat. Security Bank v. Cushman*, 121 Mass. 490; *Bank of New Milford v. New Milford*, 36 Conn. 93; *Clerks' Savings Bank v. Thomas*, 2 Mo. App. 367; *Smith v. South Royalton Bank*, 32 Vt. 341.

like an express notice served upon an authorized agent. Knowledge casually acquired by an agent is not, strictly speaking, notice to the principal; it merely affects the validity of those transactions in which the agent having the knowledge acts for and represents the principal. This distinction was pointed out by Justice Matthews in *Waynesville National Bank v. Irons*.¹ The plaintiff in that case was a bank, and the defendants were the makers of a promissory note payable to a railroad company, and indorsed by the latter to the plaintiff. It was claimed that the negotiation of the note was unauthorized, and contrary to an agreement between the makers and the railroad company, and that the plaintiff was affected with notice of the fact, because its president was also the president of the railroad company and a member of the executive committees of both companies. In his charge to the jury, Justice Matthews said: "To charge the bank with responsibility on account of any knowledge of Mr. Haines, [the president,] he must, in my opinion, be acting at the time in the name and on behalf of the bank, as its agent or representative. If he was not, but if the negotiation was in fact conducted by the cashier, and Mr. Haines declined to take any part in it, and refused to be considered as acting for either party, then the question will be, not what Mr. Haines knew, but what the bank may have known by reason of any knowledge on the part of the cashier, and is not chargeable with the knowledge of Mr. Haines."²

¹ *Waynesville Nat. Bank v. Irons*, 8 Fed. Rep. 1, 9. Compare *Fulton Bank v. New York, &c. Canal Co.*, 4 Paige Ch. 127; *Central Nat. Bank v. Levin*, 6 Mo. App. 543.

It cannot be laid down as an arbitrary rule, that the actual knowledge of a head officer or a member of the board of directors of a corporation will give rise to a presumption that he communicated his knowledge to the other officers, or acted on behalf of the company in a transaction. See *Farmers', &c. Bank v. Payne*, 25 Conn. 446; *National Bank v.*

Norton, 1 Hill, 578; *Bank of America v. McNeil*, 10 Bush, 54; *Nat. Security Bank v. Cushman*, 121 Mass. 490; *Commercial Bank v. Wood*, 7 W. & S. 89.

² See also *Miller v. Illinois Central R. R. Co.*, 24 Barb. 313; *City Bank v. Barnard*, 1 Hall (N. Y.), 70; *Nat. Bank v. Norton*, 1 Hill, 578; *Louisiana State Bank v. Senecal*, 13 La. 525; *Stevenson v. Bay City*, 26 Mich. 44; *Farrel Foundry v. Dart*, 26 Conn. 376; *Housatonic Bank v. Martin*, 1 Metc. (Mass.) 308; *Nat. Security Bank v. Cush-*

Upon similar grounds, it has been held that, when an agent of a corporation himself contracts with the company, or otherwise deals with it in a transaction in which his interests are opposed to the interests of the company, his knowledge will not be deemed the knowledge of the company as to matters connected with that transaction; for the agent could not represent the company in such a transaction.¹ So if a person is an officer of two companies, and these companies enter into dealings with each other, the knowledge of the common officer cannot be attributed to either company in a transaction in which he did not represent it.²

§ 541. **Revocation of Powers of Agents.**—It is a general rule of the law of agency, that the powers of an agent exist only at the will of his principal, and may be revoked by the latter at any time. It is immaterial whether the agent was engaged for a definite term or not. The agency and the contract of hiring are entirely distinct. The principal can withdraw the authority of the agent, even although this would be in violation of his contract; but he can rescind the contract of hiring only provided the agent proves wholly

man, 121 Mass. 490; *United States Ins. Co. v. Shriver*, 3 Md. Ch. 388; *General Ins. Co. v. U. S. Ins. Co.*, 10 Md. 527; *Stratton v. Allen*, 1 C. E. Green (N. J. Eq.), 229; *Custer v. Tompkins County Bank*, 9 Pa. St. 27; *Powles v. Page*, 3 C. B. 16.

Knowledge casually acquired by a prior agent, therefore, does not bind the principal. *Great Western Ry. Co. v. Wheeler*, 20 Mich. 419; *Platt v. Birmingham Axle Co.*, 41 Conn. 255.

¹ *First Nat. Bank v. Christopher*, 40 N. J. Law, 435; *Barnes v. Trenton Gas Light Co.*, 27 N. J. Eq. 33; *First Nat. Bank v. Gifford*, 47 Iowa, 575; *Wickersham v. Chicago Zinc Co.*, 18 Kans. 481; *Winchester v. Baltimore, &c. R. R. Co.*, 4 Md. 231; *La Farge, &c. Ins. Co. v. Bell*, 22 Barb. 54; *Lyne v. Bank of Ken-*

tucky, 5 J. J. Marsh. 545; *Loomis v. Eagle Bank*, 1 Disney, 285; *Washington Bank v. Lewis*, 22 Pick. 24; *Commercial Bank v. Cunningham*, 24 Pick. 270; *West Boston Savings Bank v. Thompson*, 124 Mass. 506; *Platt v. Birmingham Axle Co.*, 41 Conn. 255; *Peckham v. Hendren*, 76 Ind. 47.

² See *Re Marseilles, &c. Ry. Co.*, L. R. 7 Ch. App. 161; *Re Contract Co.*, L. R. 8 Eq. 14.

The mere fact that a person is an officer of two corporations will in no case charge one company with constructive notice of the affairs of the other; and the actual knowledge of the common officer will affect either company only in those transactions in which he represents it. *First Nat. Bank v. Loyhed*, 28 Minn. 396.

unfit to perform the duties he has undertaken, or has wilfully violated his obligations.¹ In applying these doctrines to the agents of a corporation, it is necessary to take into consideration the character of the corporate organization. As a rule, a corporation can act only through agents, and can revoke the powers of the latter only by means of other agents.

The directors and managing agents of a corporation have undoubted authority to revoke the powers of the inferior agents whom they have appointed. It would be practically impossible to carry on the business of a corporation without this power; it is therefore always implied. The power is a discretionary one, and the rightfulness of its exercise cannot be investigated by the courts.

But the directors of a corporation have no implied authority to revoke the powers of those agents who are appointed by vote of the shareholders, or whose office is fixed and regulated by the charter. The majority of the board clearly have no power to expel an individual director, or to exclude him from inspecting the company's books and participating in its management, although they may believe him to be hostile to the interests of the association.² So it would be difficult to imply authority in the board of directors to revoke the powers of any agent, like a president or treasurer, whose term of office is fixed by the charter or articles of association of the company.³ It does not follow that the directors have authority to remove an agent of this character merely because they appointed him pursuant to the provisions of the charter. There should be an express provision granting the power of removal.

§ 542. **Removal of Directors.** — The majority at a shareholders' meeting have no power to revoke the powers of the

¹ See Story on Agency, § 462 *et seq.*; Evans on Agency, 83.

It has been said that an exception exists in case of a "power coupled with an interest," and that a power of that description is not revocable; but the exception is only in name. The expression "power coupled with an interest" appears

to mean an interest or estate in specific property, and not, strictly speaking, a power of agency.

² *People v. Throop*, 12 Wend. 183; *Taylor v. Rundell*, 1 Y. & C. C. 128; s. c. 1 Phil. 222; *Stuart v. Lord Bute*, 12 Sim. 460.

³ Compare *Sparks v. Farmers' Bank*, 3 Del. Ch. 274.

inferior agents of a corporation because the power of appointing and controlling these agents is delegated to the board of directors exclusively. Nor have the majority at a shareholders' meeting implied authority to revoke the powers of the directors or managing agents, if their term of office is prescribed by the charter or the articles of association or by-laws of the company. The power of removing the directors of a corporation is sometimes conferred by express provision. Thus the English Companies Act of 1862 provides that "the company in general meeting may by special resolution remove any director before the expiration of his period of office, and may by an ordinary resolution appoint another person in his stead."¹ If the charter or articles of a company provide that the shareholders at a general meeting may remove any director "for negligence, misconduct in office, or other reasonable cause," the expression "reasonable cause" does not refer to such a cause as would be deemed reasonable in a court of justice, but only to such a cause as is deemed reasonable by the shareholders, and the discretion of the shareholders in determining what is reasonable cannot be interfered with, in the absence of direct fraud.²

§ 543. Remedies of Shareholders against offending Directors. — Cases may arise in which the removal of the directors of a corporation would be essential to the company's welfare. Thus, the directors may be wholly unable or unwilling to perform their duties and protect the interests of the shareholders; they may even threaten the company with wilful mismanagement and financial ruin. Under these circumstances some remedy must be found.

It has been pointed out in a preceding chapter, that the courts will grant relief, at the suit of individual shareholders

¹ 25 & 26 Vict. ch. 89. Schedule I, Table A. 65. in place of those incapable of acting. *Wilson v. Wilson*, 6 Scott, 540.

² *Inderwick v. Snell*, 2 MacN. & G. 216. The bankruptcy of a director does not necessarily vacate his office.

If a director has absconded, he is "incapable of acting," within the meaning of a clause providing for the appointment of new directors *Phelps v. Lyle*, 10 A. & E. 113; *Atlas Nat. Bank v. Gardner Co.*, 8 Biss. 537.

of a corporation, whenever the company is unable, by reason of the fault of its agents, to maintain its rights.¹ Hence, if the removal of the directors is absolutely essential to the protection of the corporation, and the corporation has no means of removing them or of revoking their powers, individual shareholders may apply to the court on behalf of the company, and the courts will grant such redress as justice requires. In a case of this kind, it would be necessary to consider the rights of the shareholders as among themselves, rather than the personal rights of the directors. The directors have no personal interest in their power of representing the corporation; they have a personal interest in their salaries alone. The power of acting for the corporation is given to the directors solely in trust for the corporation, and would be revocable by the latter if it had any means of expressing its will. The inability of the majority of a corporation to revoke the powers of the directors does not result from a want of power in the corporation, but from the absence of a delegation of power to the majority to act for the corporation in this respect.² The defence of the directors in a suit of this kind would not be made in their own interest, but in the interest of the shareholders, — each of whom has a right to have the corporation managed by the agencies provided by the charter unless these agencies wholly fail. It would seem, therefore, that a court of equity may remove the directors of a corporation from office at the suit of the corporation or a shareholder acting on its behalf, if for any reason the directors are incapable or unsuitable to perform the trust they have undertaken.

It should be observed, that the courts will not remove the directors from office, or restrain them generally from representing the corporation, except in a case of absolute necessity. Ordinarily an injunction will be issued only to restrain specific threatened wrongs. If the powers of the directors are revoked in pursuance of an order of the court, a receiver should be appointed until a meeting can be held and new directors elected by the majority.³

¹ *Supra*, § 239 *et seq.*

² *Supra*, § 541.

³ See *supra*, § 281. As to the remedies provided in New York for

§ 543 a. Remedies against Persons claiming without Right to be Officers of a Corporation. — It has been held that a court of equity has no jurisdiction to remove an officer of a corporation who is in actual possession of his office under a void election, or after his right to the office has expired or become forfeited. In *Johnston v. Jones*,¹ Chancellor Zabriskie said : “ It is clear that a court of equity has no jurisdiction to remove an officer of a corporation from an office of which he has possession, or to declare the forfeiture of such office. Its decree will not, like the judgment of a court of law, operate *in rem*, and remove or oust any one from an office which he in fact holds. When the object is simply to determine the regularity of an election, or to declare an office to which any one has been duly elected forfeited, a court of law is the only competent and proper tribunal.”

This doctrine seems to have originated in the mistaken view that the same principles apply to the removal of a person claiming to be an officer or head agent of a private incorporated company as to a *de facto* officer of a public corporation or a person in possession of a government office.²

An entire stranger to a corporation may be enjoined by a court of equity, at the suit of the corporation, from meddling with the corporate affairs, if an action for damages would not be an adequate remedy ; and there is no reason, founded upon principle, why similar relief should not be granted against a person who claims without right to be an officer or agent of the company.³ The rule excluding equitable relief in a case

the removal or suspension of officers of a corporation who have been guilty of misconduct in office, see Code of Civil Procedure, §§ 1781, 1812.

¹ *Johnston v. Jones*, 23 N. J. Eq. 216, 226. See also *Owen v. Whitaker*, 20 N. J. Eq. 122; *Neall v. Hill*, 16 Cal. 145.

² See *infra*, § 640.

³ It is difficult to perceive how the shareholders, who are the real parties in interest, have any rem-

edy under the common law, except by bill in equity, for their rights are wholly of an equitable character.

Directors who attempt to continue themselves in office by unlawful means may be enjoined at the suit of a shareholder from doing anything which will prevent a fair meeting of the shareholders, and a new election, at the regular time. *Elkins v. Camden, &c. R. R. Co.*, 36 N. J. Eq. 467, affirmed 37 N. J. Eq. 273.

of this kind has not been applied to agents of individuals or unincorporated associations, nor to the inferior agents of corporations; nor has it been applied in any case in which the person claiming the office was not in actual possession under color of right. What constitutes such possession of an office under color of right as will constitute a person an officer *de facto*, within the meaning of this rule, is not clear from the cases.

In New York it is provided by statute that it shall be the duty of the Supreme Court, upon the application of any person or persons, or body corporate, that may be aggrieved by an election, to proceed in a summary way to inquire into the cause of complaint, and to direct a new election, or make such other order as justice may require.¹ Similar statutes have been passed in other States. A shareholder is "a person aggrieved" under a statute of this description.²

The denial of jurisdiction in the courts of equity to restrain persons from acting as officers of a private corporation under a void election does not proceed from a supposed incapacity of the courts of equity to pass upon a question of this kind; for it is held that such a question may be determined by a court of equity in a collateral proceeding, though not in a proceeding directly against the claimants of the office. In *Johnston v. Jones*,³ the Chancellor said: "If the question of the legality of an election, or whether a certain person holds such an office, arises incidentally in the course of a suit of which equity has jurisdiction, that court will inquire into and decide it, as it would any other question of law or fact that arises in the cause. But the decision is only for the purpose of the suit; it does not settle the right to the office, or vacate it if the party is in actual possession."³

§ 544. **Contract of Hiring not rescinded by Revocation of Authority.** — A principal has an absolute right to revoke the

¹ R. S. 603, § 5. Laws of 1825, 451, § 9; amended Dec. 10, 1828, § 15. ² *Johnston v. Jones*, 23 N. J. Eq. 216, 226. See also *Mechanics' Nat. Bank v. Burnet Manuf. Co.*, 32 N. J. Eq. 236.

³ *Re St. Lawrence Steamboat Co.*, 44 N. J. Law, 529.

powers of his agent at any time; but he cannot rescind the contract of hiring, or refuse to pay the agent his salary, in absence of a sufficient cause. There must be wilful negligence or misfeasance on the part of the agent, or he must be wholly incapable, through want of skill, of performing the duties he has undertaken. The same rule applies to corporations. If a corporation violates its contract with any of its agents, and refuses to pay the salary agreed upon, the agent may recover his damages in an action against the company.

§ 545. **Relation between a Corporation and its Promoters.** — A person, who, by his active endeavors, assists in procuring the formation of a company and the subscription of its shares, is commonly called a promoter. The word "promoter" has no technical legal meaning, and applies to any person who takes an active part in inducing the formation of a company, whether he afterwards becomes connected with the company or not.¹

It frequently happens, that persons owning property which is adapted to business uses bring about the formation of a company, for the purpose of selling the property to the company at a profit, and providing the money to pay the purchase price by inducing others to subscribe for shares. There is no rule of law prohibiting a transaction of this description.² The rule which prohibits an agent or trustee from obtaining a profit at the expense of his principal or *cestui que trust* clearly has no application under these circumstances; for the fact that a person has assisted in forming a company, and in inducing others to subscribe for shares, neither constitutes

¹ See an article by Adelbert Hamilton in 16 Am. L. Rev. 671.

In *Whaley Bridge, &c. Co. v. Green*, L. R. 5 Q. B. D. 109, 111, Bowen, J., said: "The term 'promoter' is a term not of law, but of business, usefully summing up, in a single word, a number of business operations familiar to the commercial world, by which a company is generally brought into existence."

² See *Erlanger v. New Sombbrero Phosphate Co.*, 3 App. Cas. 1236, *per* Lord Cairns, L. C.; *Gover's Case*, L. R. 1 Ch. Div. 182; *Albion Steel, &c. Co. v. Martin*, L. R. 1 Ch. Div. 580; *Densmore Oil Co. v. Densmore*, 64 Pa. St. 43; *Lungren v. Pennell*, 10 W. N. C. 297 (Sup. Ct. of Pa.). See also *supra*, § 291.

him an agent of the company, nor gives rise to the legal relation of trustee and *cestui que trust*.

But the relation between the promoters of a corporation and its agents and shareholders is often of such a character as to render their dealings liable to be scrutinized by the courts with great strictness. Promoters of a company usually represent themselves to be deeply interested in its success, and are instrumental in inducing the subscriptions of the shareholders by means of representations and promises in relation to the projected enterprise. As a rule, the promoters possess absolute control over the policy and operations of the company when it is first formed, and in many instances the first board of directors of the company consists of nominees of the promoters, and is wholly within their control. The subscriptions of the shareholders are made upon the trust that the promoters are men of rectitude and business sagacity, who will use their knowledge, and exercise their control over the enterprise, for the benefit of the company.

It is evident that a corporation dealing with its promoters under such circumstances would not meet them on an equal footing. It would not be represented by independent agents, acting wholly in the interests of the shareholders. The promoters would, therefore, be bound to exercise the highest degree of fairness in their dealings. Justice demands that the promoters of a company should not abuse the confidence placed in them by the subscribers for shares, or derive any unjust advantage through their control over the organization or management of the company.

§ 546. **Liability of Promoters for Frauds upon the Corporation.** — Accordingly, it has been held that, if persons start a company, and induce others to subscribe for shares, for the purpose of selling property to the company when organized, they must faithfully disclose all facts relating to the property which would influence those who form the company in deciding upon the judiciousness of the purchase. If the promoters are guilty of any misrepresentation of facts or suppression of the truth in relation to the character and value of the property, or their personal interest in the proposed

sale, the company will be entitled to set aside the transaction, or recover compensation for any loss which it has suffered.¹

In those cases where the scheme of organization gives the promoters the power of selecting the directors who are to represent the company in the proposed purchase, they are bound to select competent and trustworthy persons, who will act honestly in the interest of the shareholders. A purchase made from the promoters under these circumstances will not bind the company, unless it was a fair and honest bargain.²

§ 547. Liability of a Corporation for the Acts of its Promoters. — A corporation is not responsible for acts performed, or contracts entered into, before it came into existence, by promoters or other persons assuming to bind the company in advance. It is clear that the corporation cannot, in such

¹ *Bagnall v. Carlton*, L. R. 6 Ch. Div. 385; *Emma Silver Mining Co. v. Grant*, L. R. 11 Ch. Div. 918; *New Sombbrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73; 3 App. Cas. 1218; *Hichens v. Congreve*, 1 R. & M. 150; *Simons v. Vulcan Oil, &c. Co.*, 61 Pa. St. 202; *Short v. Stevenson*, 63 Pa. St. 95; *McElhenny's Appeal*, 61 Pa. St. 188; *St. Louis, &c. Mining Co. v. Jackson*, 5 Cent. L. J. 317. See 16 Am. L. Rev. 671; and compare *supra*, §§ 291, 292.

² See *New Sombbrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. Div. 73; 3 App. Cas. 1218. Lord Cairns, L. C., in delivering judgment in the House of Lords, said: "Promoters stand, in my opinion, undoubtedly in a fiduciary position. They have in their hands the creation and moulding of the company; they have the power of defining how, and when, and in what shape, and under what supervision, it shall start into existence and begin to act as a trading corporation. If they are doing all this in order that the company may,

as soon as it starts into life, become, through its managing directors, the purchaser of the property of themselves, the promoters, it is, in my opinion, incumbent upon the promoters to take care that in forming the company they provide it with an executive, that is to say, with a board of directors, who shall both be aware that the property which they are asked to buy is the property of the promoters, and who shall be competent and impartial judges as to whether the purchase ought or ought not to be made. I do not say that the owner of property may not promote and form a joint-stock company, and then sell his property to it, but I do say that, if he does, he is bound to take care that he sells it to the company through the medium of a board of directors who can and do exercise an independent and intelligent judgment on the transaction, and who are not left under the belief that the property belongs, not to the promoter, but to some other person." 3 App. Cas. 1236. See also p. 1268.

case, be held liable on any principle of the law of agency, for an agency implies the existence of a principal and a delegation of authority from the principal to the agent.¹

§ 548. **Adoption of Acts of Promoters.**—A corporation may, however, make itself responsible for such acts and contracts by subsequently adopting them. The liability of the corporation under these circumstances does not rest upon a supposed agency of the promoters, and a ratification of their acts, but upon the immediate and voluntary act of the company. If an agreement is made with promoters or persons about to form a corporation, and the parties intend that the corporation, when formed, shall become a party to the agreement, such agreement would usually constitute or include an open offer, which may be accepted by the corporation after it is formed. And this is true whether the promoters are primarily liable or not. If the promoters are not made liable primarily, the agreement would, in effect, be a naked offer or project until accepted by the corporation after it has been formed; if the promoters are liable, an offer would ordinarily be implied to substitute the corporation in their place by a novation. The real character and effect of an agreement or transaction with promoters necessarily depends, in each case, upon the intention of the parties who enter into it; there is no arbitrary rule of law which would defeat this intention, or create a liability on the part of either the corporation or the promoters, where none was contemplated.²

¹ *Payne v. New South Wales Coal, &c. Co.*, 10 Exch. 283; *Gunn v. London, &c. Fire Ins. Co.*, 12 C. B. n. s. 694; *Caledonian, &c. Ry. Co. v. Helensburgh Harbor*, 2 Jur. n. s. 695; s. c. 2 Macq. 391; *Rockford, &c. R. R. Co. v. Sage*, 65 Ill. 328; *Safety Deposit, &c. Ins. Co. v. Smith*, 65 Ill. 309; *Western Screw, &c. Co. v. Cousley*, 72 Ill. 531; *New York, &c. R. R. Co. v. Ketchum*, 27 Conn. 170; *Franklin Fire Ins. Co. v. Hart*, 31 Md. 59; *Frost v. Belmont*, 6 Allen, 152; *Marchand v. Loan, &c. Ass.*, 26 La. Ann. 389; *Bell's Gap R. R. Co.*

v. Christy, 79 Pa. St. 54. Compare *Low v. Connecticut, &c. R. R. Co.*, 45 N. H. 370; 46 N. H. 284; *Perry v. Little Rock, &c. Ry. Co.*, 44 Ark. 383; *Hall v. Vermont, &c. R. R. Co.*, 28 Vt. 401; and cases in the following notes. See also 16 Am. L. Rev. 281.

A corporation is not liable to promoters for services rendered before the incorporation of the company, unless expressly provided by its charter or articles of association. *Franklin Fire Ins. Co. v. Hart*, 31 Md. 60.

² See *Scott v. Ebury*, 36 L. J.

The offer which is implied in an agreement with promoters assuming to act in behalf of a proposed corporation may be accepted by the latter, either at the time of its formation, or subsequently, through the usual agencies. If the charter or articles of association of the company refer to the agreement, and provide that the company shall become a party thereto, it is evident that the agreement would be binding upon the company from its inception, by reason of the unanimous consent of the shareholders.¹ A similar rule applies where two companies form a new company by consolidation, and the new company is made a party to the contracts of the old companies by the agreement of consolidation.²

§ 549. **Power of Agents of a Corporation to adopt an Engagement of its Promoters.** — The right of the agents of a corporation to adopt an agreement originally made by its promoters, depends upon the purposes of the company and the nature of the agreement. If the agreement appears to be a reasonable means of carrying out any of the company's authorized purposes, the usual agents of the company have implied authority to adopt it; but they have no authority to adopt it under any other circumstances. There is no difference in this respect between the adoption of an agreement originally made by promoters, and the formation of an entirely new contract.³

The adoption of an agreement made by the promoters of a corporation may often be implied from the acts or acquiescence of the corporation or its agents, without any express

C. P. 161; *Landman v. Entwistle*, 7 Exch. 632; *Higgins v. Hopkins*, 3 Exch. 163.

¹ See *Tilson v. Warwick Gaslight Co.*, 4 B. & C. 962; *Shaw's Claim*, L. R. 10 Ch. 177; *Caledonian, &c. Ry. Co. v. Helensburgh Harbor*, 2 Macq. 391, 405.

² See *infra*, §§ 952-957.

³ *Western Screw &c. Co. v. Cousley*, 72 Ill. 531; *Rockford, &c. R. R. Co. v. Sage*, 65 Ill. 328; *Williams v. St. George's Harbor Co.*, 2 De G.

& J. 547; *Little Rock, &c. R. R. Co. v. Perry*, 37 Ark. 164; *Bommer v. American Spiral Spring, &c. Co.*, 81 N. Y. 468; *Whitney v. Wyman*, 101 U. S. 392; *Spiller v. Paris Skating Rink Co.*, L. R. 7 Ch. Div. 368; *Preston v. Liverpool, &c. Ry. Co.*, 5 H. L. C. 605. Compare *Kelner v. Baxter*, L. R. 2 C. P. 174; *Melhado v. Porto Alegre, &c. Ry. Co.*, L. R. 9 C. P. 503; *Scott v. Ebury*, 36 L. J. C. P. 161.

acceptance. After a corporation has knowingly received the benefit of an engagement entered into by its promoters, it will usually not be permitted to deny that it agreed to assume the corresponding burdens.¹

A corporation cannot be charged with the acts or contracts of its promoters, by virtue of the technical doctrine of ratification. This doctrine applies only to acts performed on behalf of an existing principal. Ratification operates retrospectively, and amounts, in legal effect, to an original grant of authority. By virtue of this doctrine, a principal is made responsible for an act or contract to which he was not in fact a party, and which he never authorized, by simply giving his assent. On the other hand, the adoption by a corporation of an agreement made with its promoters involves the creation of a new agreement, and is governed by all the rules applicable to the formation of a contract, under the common law.

§ 550. **Liability of Agents to the Corporation.** — The nature of the duties resting upon an agent, and the degree of care and skill which he is bound to exercise, depend upon the character of the office or employment which the agent has assumed. Every agent is bound, by the implied terms of his contract of agency, to serve his principal faithfully in the office which he has undertaken. If an agent violates this contract, he is liable to the principal for the consequences; and this is true, whether the breach of duty consists of an active misfeasance or merely of passive neglect of the obligations assumed.

An agent is liable for torts committed against his principal to the same degree as a stranger under similar circumstances. If an agent is guilty of an unauthorized act, constituting a positive misapplication of property or invasion of rights belonging to the principal, the latter may hold the agent responsible both for the tort and for the breach of the contract

¹ Compare *Edwards v. Grand Chester, &c. Ry. Co.*, 3 My. & Cr. Junction Ry. Co., 1 My. & Cr. 650; 773; *Low v. Connecticut, &c. R. R. Petre v. Eastern Counties Ry. Co.*, Co., 45 N. H. 370; *Bell's Gap R. R. 1 Eng. Ry. Cas. 462*; *Stanley v. Co. v. Christy*, 79 Pa. St. 54.

of agency. An agent who has charge of funds belonging to the principal may likewise be liable in equity to account for these funds. These doctrines apply to the agents of a corporation, as well as to the agents of an individual.

The remedy of the principal for a breach of the contract of agency, or a wrongful interference with the property of the principal, is by a common law action for damages.¹ If the agent has incurred an obligation to account for property or funds received for the principal, this obligation may be enforced by bill in equity; and, if the agent has received the legal title to property or funds equitably belonging to the principal, or has applied such property or funds to his own use, the principal may in either case charge the agent in equity as a trustee.²

§ 551. **The Duty of Directors to exercise Care.**—The directors or trustees of a corporation are charged with the general supervision and management of the company's affairs. The amount of attention and care which the proper performance of these duties requires evidently depends upon the character of the business in which the company is engaged. Directors of a company not engaged in active business, or whose business is of a routine character, such as a turnpike company, may have no other duties than to hold occasional meetings for the purpose of appointing officers and examining the company's accounts. On the other hand, directors of a banking, manufacturing, or trading company may be obliged to exercise active control in supervising and directing the company's policy and business operations. If a director wilfully neglects or fails, without sufficient excuse, to use as much attention and care in performing the duties of his office as the proper performance of these duties necessitates, he is liable to the corporation for any resulting loss.³

¹ See *Hun v. Cary*, 82 N. Y. 65, 80; *Godbold v. Branch Bank*, 11 Ala. 191; *Overend v. Gurney*, L. R. 4 Ch. App. 701.

² As to the statutes of limitations applicable to suits against directors and other agents for misconduct in

office, see *Brinckerhoff v. Bostwick*, 99 N. Y. 185, reversing s. c. 34 Hun, 352; *Williams v. Halliard*, 38 N. J. Eq. 373, 378; *Spering's Appeal*, 71 Pa. St. 11.

³ In *Hun v. Cary*, 82 N. Y. 71, Earl, J., said: "It is impossible to

§ 552. **The Degree of Care to be exercised by Directors.**— Attempts have been made to define the degree of care and prudence which directors must exercise in the performance of their duties. In some of the cases it has been said, that, inasmuch as directors are usually not paid for their services, they are to be regarded as *mandataries*, — persons who have gratuitously undertaken to perform certain duties, and are bound to exercise only ordinary care and prudence, — and that they are liable to the corporation only for what is called *crassa negligentia*, or gross negligence.¹ But all this is, at the best, misleading. The plain and obvious rule is, that directors impliedly undertake to use as much diligence and care as the proper performance of the duties of their office requires. What constitutes a proper performance of the duties of a director is a question of fact, which must be determined in each case in view of all the circumstances; the character of the company, the condition of its business, the usual methods of managing such companies, and all other relevant facts must be taken into consideration. It is evident that no abstract reasoning can be of service in reaching a proper solution.

give the measure of culpable negligence for all cases, as the degree of care required depends upon the subjects to which it is to be applied. What would be slight neglect in the care of a quantity of iron might be gross neglect in the care of a jewel. What would be slight neglect in the care exercised in the affairs of a turnpike corporation, or even of a manufacturing corporation, might be gross neglect in the care exercised in the management of a savings bank intrusted with the savings of a multitude of poor people, depending for its life upon credit, and liable to be wrecked by the breath of suspicion."

¹ See *Spering's Appeal*, 71 Pa. St. 11, *per* Sharswood, J.; *Vance v. Phoenix Ins. Co.*, 4 Lea (Tenn.),

388; *Dunn's Admr. v. Kyle's Exr.*, 14 Bush, 134.

At common law a person who agrees without any consideration to act as bailee or trustee for another is not liable if he refuses to perform his agreement at all; but if he enters upon the performance of his agreement, he is bound to exercise reasonable care and attention. These doctrines have no application to directors whose duties are indicated by the charter or act of the legislature under which the company was formed. The directors, by accepting their appointment, impliedly assume such obligations as the incorporating law provides. The common law rule that a contract requires a consideration may be dispensed with altogether by statute.

The law upon this subject was carefully considered by the Court of Appeals of New York in *Hun v. Cary*,¹ and the conclusion was reached, that the directors or trustees of a corporation are bound to manage the affairs of the company with the same degree of care and prudence which is generally exercised by business men in the management of their own affairs.

§ 553. **Directors not liable for Mistakes of Judgment.** — The directors of a corporation are intrusted with wide discretionary powers. They are bound to exercise these powers with the utmost good faith in the interest of the corporation, and to give the latter the benefit of their best judgment; but they are not liable for innocent mistakes. Directors merely undertake to make honest use of such judgment as they possess. They do not insure the correctness of their judgment; and they cannot be charged with the consequences of an honest error of judgment or accidental mistake in the exercise of their discretionary powers.²

§ 554. **But the Directors are bound to use reasonable Care and Skill.** — Directors are not merely bound to be honest; they must also be diligent and careful in performing the duties which they have undertaken. They cannot excuse imprudence on the ground of their ignorance or inexperience, or the honesty of their intentions; and if they commit an error of judgment through mere recklessness or want of ordinary prudence and skill, the corporation may hold them responsible for the consequences.

The decision of the Court of Appeals of New York, in *Hun v. Cary*,³ is in accordance with these views. The direc-

¹ *Hun v. Cary*, 82 N. Y. 65. See also *Charitable Corporation v. Sutton*, 2 Atkyns, 405; *Litchfield v. White*, 3 Sandf. 545; *Scott v. De Peyster*, 1 Edw. Ch. 513, 543; *Hodges v. New England Screw Co.*, 1 R. I. 312. See the very able opinion of Porter, J., in *Percy v. Millaudon*, 8 Mart. N. S. (La.) 68.

² *Spring's Appeal*, 71 Pa. St. 11; *Hun v. Cary*, 82 N. Y. 74;

Smith v. Prattville Manuf. Co., 29 Ala. 503; *Overend v. Gurney*, L. R. 4 Ch. 701; L. R. 5 H. L. 480; and other cases cited in the following sections.

³ *Hun v. Cary*, 82 N. Y. 74. See also *Mutual Building, &c. Bank v. Bossieux*, 4 Hughes C. Ct. 387; *Percy v. Millaudon*, 8 Mart. N. S. (La.) 68; *Shea v. Mabry*, 1 Lea (Tenn.), 319.

tors of a savings bank, whose entire assets consisted of about seventy thousand dollars, purchased a piece of land for thirty thousand dollars, and erected a banking-house upon it at a cost of twenty-seven thousand dollars more. The bank had never been profitable, and was practically insolvent at the time. It subsequently failed, and a receiver was appointed, who sued the directors for the damages caused by the improper investment of its fund. A judgment was rendered against the defendants, and was affirmed by the Court of Appeals. Earl, J., delivering the opinion, said: "One who voluntarily takes the position of director, and invites confidence in that relation, undertakes, like a mandatary, with those whom he represents or for whom he acts, that he possesses at least ordinary knowledge and skill, and that he will bring them to bear in the discharge of his duties. Such is the rule applicable to public officers, to professional men, and to mechanics, and such is the rule which must be applicable to every person who undertakes to act for another in a situation or employment requiring skill and knowledge; and it matters not that the service is to be rendered gratuitously. These defendants voluntarily took the position of trustees of the bank. They invited depositors to confide to them their savings, and to intrust the safe-keeping and management of them to their skill and prudence. They undertook, not only that they would discharge their duties with proper care, but that they would exercise the ordinary skill and judgment requisite for the discharge of their delicate trust. . . . Whether, under the circumstances, the purchase was such as the trustees, in the exercise of ordinary prudence, skill, and care, could make, or whether the act of purchase was reckless, rash, extravagant, showing a want of ordinary prudence, skill, and care, were questions for the jury." ¹

§ 555. **Liability of Directors for Unauthorized Acts.**—If directors of a corporation wilfully do an act which they know or ought to know to be unauthorized, they are clearly liable to the corporation for resulting damages. Directors are liable, therefore, if they do an act which is expressly prohibited by

¹ 82 N. Y. 74, 77.

the company's charter or by-laws; for they are bound, by the duties of the office which they have assumed, to observe every provision contained in the company's charter or by-laws. Thus it has been held that directors are liable to the corporation, if they make a loan of corporate funds to an unauthorized amount, or upon a prohibited security, or without any security where security is expressly required.¹

Directors are equally liable for damages resulting from an act in excess of their chartered powers, although the act may not be expressly prohibited, or in excess of the company's chartered powers. Thus, directors are liable if they use their control over the company to obtain a personal advantage at the company's expense, or if they wrongfully create obligations binding upon the company, or cause its property to be wasted or misapplied.²

§ 556. **Effect of Statutory Prohibitions.**—The liability of directors for damages caused by acts expressly prohibited by the company's charter or act of incorporation is not created by force of the statutory prohibition. The performance of acts which are illegal or prohibited by law may subject the corporation to a forfeiture of its franchises, and the directors to criminal liability; but this would not render them civilly liable for damages. The liability of directors to the corporation for damages caused by unauthorized acts rests upon the common law rule which renders every agent liable who violates his authority to the damage of his principal. A statutory prohibition is material under these circumstances merely as indicating an express restriction placed upon the powers delegated to the directors when the corporation was formed.

§ 557. **Directors not responsible for an Excusable Mistake of Law.**—It is often very difficult in practice to determine whether or not a given act is within the powers of the directors of a corporation. Charters and by-laws sometimes contain provisions which are extremely vague and uncertain; and

¹ *Citizens' Building Ass. v. Coriell*, 34 N. J. Eq. 383. See also *Oakland Bank v. Wilcox*, 60 Cal. 126.

² See *Percy v. Millaudon*, 8 Mart. N. S. (La.) 68; *Shea v. Mabry*, 1 Lea (Tenn.), 319; *Neall v. Hill*, 16 Cal. 149, 151.

the authority of the directors to do an act may depend upon complicated questions of law. Under these circumstances, the directors are not obliged to act at their peril. They are undoubtedly bound to act in good faith, and to exercise due skill and care to ascertain the exact measure of their powers. Directors can never set up as a defence, that they were ignorant of a provision of the company's charter or by-laws; and if they are in doubt about a point of law, or the construction of the charter or by-laws, they should consult competent counsel. But they ought not to be held responsible if they exceed their allotted powers, notwithstanding the exercise of due diligence and caution.

The decision of the Court of Appeals of Pennsylvania in Spring's Appeal,¹ is in accordance with this view. Sharswood, J., said: "In regard to the question whether the defendants should be held responsible for any of their acts and investments as *ultra vires*, it might be sufficient to notice the fact that the charter of this corporation was a very complicated one, made up by comparing together no less than sixteen different acts of incorporation or supplements. To have mistaken the extent of their powers under such circumstances would not have been a matter of surprise, even in the most timid and cautious. We may adopt upon this point the language of C. J. Greene, in *Hodges v. New England Screw Co.*²: 'In considering the question of the personal responsibility of the directors, we shall assume that they violated the charter of the Screw Company. The question then will be, Was such violation the result of mistake as to their powers, and if so, did they fall into the mistake from want of proper care, such care as a man of ordinary prudence practises in his own affairs? For if the mistake be such as with proper care might have been avoided, they ought to be liable. If, on the other hand, the mistake be such as the directors might well make, notwithstanding the exercise of proper care, and if they acted in good faith for the benefit of the Screw Company, they ought not to be liable.' We may say in this case, con-

¹ Spring's Appeal, 71 Pa. St. 24. Co., 1 R. I. 312, 346; Williams v.

² Hodges v. New England Screw McDonald, 37 N. J. Eq. 409.

ceding that the directors did violate the charter, it was a question upon which, with all due care, they might have made an honest mistake; and, moreover, it appears by the evidence, and is so reported, that they acted throughout by the advice of their counsel. It is well settled that trustees will be protected from responsibility under such circumstances."

§ 558. **Mistake of Law may be excusable, though not under Advice of Counsel.** — Directors are not bound at their peril to act always under advice of counsel. This would be extremely inconvenient in practice, and would subject the company to much unnecessary expense. Directors should consult counsel only when the importance of the occasion renders this advisable, or when they are in doubt concerning the law. They should act as a prudent business man would act under similar circumstances in managing his own affairs. Directors are not liable if they fail to consult counsel, and commit an error of law while acting in good faith, and with the degree of skill and prudence which may reasonably be expected of business men under the circumstances.¹

§ 559. **Advice of Counsel not necessarily an Excuse.** — The fact that directors have acted under advice of counsel is not necessarily an excuse for an excess of their authority. The fundamental rule is, that directors are bound at all times to act in perfect good faith, and to exercise reasonable skill and prudence. If they fail in this, they are liable whether they have consulted counsel or not. Directors must consult counsel if the exercise of reasonable skill and prudence requires

¹ See *Vance v. Phoenix Ins. Co.*, 4 Lea (Tenn.), 385. The facts of this case were as follows. The by-laws of a corporation contained a provision that the board of directors should elect a secretary, and require the latter to give a bond with sureties for the faithful performance of his duties. The directors elected a secretary, and took the prescribed bond, and at the end of his term of office re-elected the same person for two further terms, but failed to take

a new bond. In the third term of his office the secretary became a defaulter. The court decided that the directors were not liable to make good the loss to the corporation, they having decided in good faith, though erroneously, and without taking legal advice, that the bond first taken was a continuing security, and that no new bond was required. See also *Godbold v. Branch Bank*, 11 Ala. 191; *Percy v. Millaudon*, 8 Mart. n. s. 68.

this to be done; and the counsel must be of such professional reputation and character as the exigency of the case requires. Good faith is always essential. Directors cannot shield themselves from liability for acts which they ought to know to be unauthorized, by obtaining advice from counsel upon whose opinion no prudent man would rely under the circumstances.

§ 560. Directors not responsible for an excusable Mistake of Fact. — The authority of directors to do an act cannot be determined without regard to the circumstances under which the act is done. An act which would be authorized under a particular state of facts may be wholly unauthorized under other circumstances.¹ Directors are bound to use due care to ascertain the existence of the state of facts upon which their authority to act depends; if they are in doubt, they should make a careful investigation; but they are not liable for an innocent mistake made in the exercise of due skill and care.

Thus, if the directors of a corporation are expressly prohibited from paying dividends except out of actual profits, they are bound to use diligence and care to ascertain whether profits have in truth been earned; but they are not liable for erroneously paying a dividend out of the company's capital, if they have made a careful investigation of the company's accounts, and believe in good faith that profits to pay the dividend have been earned.²

§ 561. Liability for Failure to watch over the Company's Interests. — Wrongs committed by Co-agents. — Directors by accepting their appointment to office impliedly agree to give as much time and attention to the interests of the corporation as the proper care of these interests requires.³ If directors fail to perform the duty thus undertaken, they are liable to the corporation for any resulting loss. Thus, if directors pay no attention to the management of the company's business or the care of its property, and the business is thereby wrecked or the property lost, they may be held responsible by the cor-

¹ See *supra*, § 362.

also *Stringer's Case*, L. R. 4 Ch.

² *Excelsior Petroleum Company v. Lacey*, 63 N. Y. 422. See

476.

³ See *supra*, § 550 *et seq.*

poration. So if directors leave entire control over the company's interests to other agents, and fail to exercise the proper supervision, they are liable for breaches of trust committed by those in control, which due care and attention on the part of the directors would have prevented.¹

In practice it is often difficult to determine whether a loss caused by the immediate wrong of agents whom the directors have given control over the company's interests can fairly be attributed to inattention or neglect of duty on the part of the directors. Directors are not insurers of the fidelity of their co-directors, or of the agents whom they have appointed. Agents appointed by the directors are agents of the corporation, and not of the directors themselves. Directors cannot be charged with the acts of their appointees on any principle of the law of agency. Directors can be held responsible for a loss resulting from wrongful acts or omissions of other directors or agents only provided the loss was a consequence of their own neglect of duty, either in failing to supervise the company's business with attention, or in neglecting to use proper care in the appointment of inferior agents.

Thus, if directors of a bank have used due care in selecting a cashier, they are not liable for a defalcation of the cashier which proper attention to their duties would not have prevented.² But if a cashier has committed a series of frauds which proper care on the part of the directors would have exposed and thus rendered impossible, the corporation may hold the directors responsible for those losses which resulted through their want of care.

§ 562. **Liability for Acts of other Officers.**—Directors who participate in wrongs committed by their co-directors or other agents, or who have notice of the wrongs and fail to take such measures as lie within their power to prevent their commission, are clearly liable to the corporation for the resulting damages.³

¹ *Charitable Corporation v. Sutton*, 2 Atkyns, 400; *Shea v. Mabry*, 1 Lea (Tenn.), 319; *Scott v. Depeyster*, 1 Edw. Ch. 513.

14 Bush (Ky.), 134; *Batchelor v. Planters' Nat. Bank*, 78 Ky. 435; *Scott v. Depeyster*, 1 Edw. Ch. 513.

² *Dunn's Admr. v. Kyle's Exr.*, 595; *Joint Stock Discount Co. v.*

³ See 1 Lindley on Partnership,

But if a director has no notice of wrongs committed by his co-directors or by other agents, and is guilty of no neglect of duty in failing to prevent them, he cannot be held responsible.¹

§ 563. **Resignation of Directors.** — By accepting their appointment to office the directors impliedly agree to perform the duties which are incident to the office so long as their agency lasts. But they may ordinarily terminate their agency at any time by resignation. This right seems to result from the implied consent of the corporation, for it is evident that the shareholders of a corporation would not desire the delicate duties which devolve upon directors to be performed by unwilling agents.²

Directors who wish to terminate their liability to perform the duties of their office should express their wish in an orderly manner, by resignation, so that new directors may be elected. But it seems that, if a director has tendered his resignation to the proper authority, he cannot be charged by reason of a failure to act as director thereafter, although the resignation may not have been accepted.³

Brown, L. R. 8 Eq. 381; Land Credit Co. v. Fermoy, L. R. 5 Ch. 763.

Directors are jointly and severally liable for all wrongful acts to which they are parties or privies. They are also jointly and severally liable for the results of their joint neglect. But where directors are charged in equity to account for the appropriation of corporate funds, or for profits improperly received by them, they are liable only severally to account for their own receipts. They may, however, be jointly and severally liable for having caused or permitted the misappropriation, in addition to the several liability of each to account in equity for what he has received. Compare *Parker v. McKenna*, L. R. 10 Ch. 96; *General Exchange Bank v. Horner*, L. R. 9 Eq. 480; *Franklin Ins. Co. v. Jenkins*, 3 Wend. 130.

¹ *Ashhurst v. Mason*, L. R. 20

Eq. 225; *Perry's Case*, 34 L. T. N. s. 716; *Williams v. Halliard*, 38 N. J. Eq. 373, 377.

² The circumstance that directors serve without compensation, and receive no technical consideration for their undertaking, is not in itself a sufficient ground for holding that they may terminate their office at will. The question is one of construction, taking into consideration the customs of business.

³ In *Chandler v. Hoag*, 2 Hun, 613, affirmed 63 N. Y. 624, it was held that a director who had sent in his resignation could not be held liable under the statute rendering the directors liable for failure to make, publish, and file annual reports, although the resignation had not been accepted and entered on the minutes of the corporation. See also *Blake v. Wheeler*, 18 Hun, 496, affirmed *sub nom. Bonnell v. Gris-*

Directors, however, cannot escape from liabilities already incurred, by terminating their agency; and they are chargeable with the losses resulting after the termination of their agency from breaches of duty previously committed. It seems clear, also, that directors cannot terminate their agency, or accept the resignation of others, if the immediate consequence would be to leave the interests of the company without proper care and protection.

§ 564. A distinction should be observed between the obligation of directors to act as agents or business managers of the corporation, and their obligation to perform those ministerial duties which are necessary to perpetuate the corporate organization. Directors cannot divest themselves of their legal status as part of the corporate organization except in a manner prescribed by law. If their term of office is fixed by the charter at a definite period, they continue legally to be officers of the company, and are bound to call meetings, and to do such other ministerial acts as are necessary to protect the corporate organization, until their term of office has expired or their resignation has been accepted by competent authority. They are bound to perform these duties, although their obligation to devote themselves to the active management of the company's business may have ceased.

§ 565. **Liability of Agents to Shareholders at Common Law.** — It has been pointed out in a previous chapter that the shareholders in a corporation cannot sue individually for damages suffered through wrongful acts affecting the corporation as a body.¹ Directors or other agents of a company, therefore, are not liable to the shareholders for breaches of duty to the corporation.² The remedy for acts in violation of the corporate rights must be obtained through the corporation. If the corporation is prevented from suing, the shareholders should proceed by bill in equity on its behalf.³

wold, 80 N. Y. 128; *Bruce v. Platt*, 80 N. Y. 379; *Squires v. Brown*, 22 How. Pr. 35, 44; *Smith v. Danzig*, 64 How. Pr. 320.

Bosw. 675; *Smith v. Hurd*, 12 Metc. (Mass.) 371.

³ *Ackerman v. Halsey*, 37 N. J. Eq. 356, affirmed 38 N. J. Eq. 501, was a suit brought by a person, who was a shareholder and creditor of

¹ *Supra*, § 235 *et seq.*

² See *Gardiner v. Pollard*, 10

A shareholder can in no case recover damages from the directors for a mere non-performance of their obligations to the corporation; and this is true although the individual rights of the shareholder, as against the corporation, may be infringed thereby. The reason of this is, that the directors are agents of the corporation as a body, and not of the individual shareholders. The corporation alone can compel its agents to do their duty, or recover damages for non-performance thereof.

Thus, if the agents of a corporation should wrongfully refuse to pay to a shareholder the dividends to which he is entitled, they would not be liable to the shareholder in an action for damages.¹ The claim of the shareholder would be against the corporation itself, for the failure on its part to perform a legal obligation to him. The wrongful acts of the company's agents would not discharge this obligation; the shareholder would be entitled to recover his dividends in an action against the company, and the company would alone have a right to complain of its agents.

Upon the same principle, it follows that the agents of a company are not liable in damages to a purchaser of shares for refusing to allow a transfer to be executed on the company's books,² or for refusing to issue a certificate to a share-

an insolvent national bank, to recover for losses caused by the wrongful acts of the directors, and the corporation, the receiver, and the directors were all made defendants. Chancellor Runyon said: "The liability is to the corporation in the first instance, where the corporation is capable of acting; but if it refuses to do so, then a person aggrieved may bring suit. If the corporation be insolvent, and its affairs in the hands of a receiver, he may maintain the litigation. If he refuses, or is himself involved, a person aggrieved may sue." See also *Williams v. Halliard*, 38 N. J. Eq. 373, 376, and *supra*, § 235 *et seq.*

¹ *French v. Fuller*, 23 Pick. 108.

The directors and shareholders in a corporation may deal with each other individually as freely as strangers. There is no trust relation between directors and shareholders except with regard to the management of the corporate interests. *Gillett v. Bowen*, 23 Fed. Rep. 625; *Deaderick v. Wilson*, 8 Baxter, 108.

² *Denny v. Manhattan Co.*, 2 Denio, 115. A different principle may apply where the agents of a company wrongfully refuse to allow a shareholder to transfer his shares and thereby cause him to incur individual liability to creditors.

holder. So, a person who has entered into a contract with a corporation cannot hold the agents of the company liable for having caused it to violate the contract, but they must seek their remedy in an action against the corporation.¹

§ 566. **Liability of Directors for Acts impairing the Value of Shares.**—The distinction between the individual rights and the collective or corporate rights of shareholders is of much importance in determining what remedies the shareholders must pursue for wrongful acts impairing the value of their shares.

If the value of shares is impaired by wrongful acts affecting the property or business of the corporation, the corporation itself is the proper complainant, because the injury is to the collective or corporate rights of all the shareholders. Under these circumstances, the individual shareholders cannot sue the wrongdoers for damages by reason of the depreciation of the value of their shares, but must obtain redress through the corporation. Any relief obtained by the corporation would, of course, inure to the benefit of the shareholders indirectly.

Accordingly, it has been held that shareholders cannot recover damages for a depreciation of the value of their shares caused by embezzlement of the corporate funds, or by wrongful acts affecting the company's business or property.²

§ 567. On the other hand, if the value of shares is impaired by wrongful acts affecting the shares directly, and not merely by impairing the value of the corporate estate which they represent, the shareholders must sue individually for their damages. Thus, if the salable value of particular shares is impaired by mutilation or destruction of the certificates, or by creating uncertainty as to the validity of the shares themselves, those persons who are aggrieved thereby must seek their remedy in an action for damages against the wrongdoers. The same rule applies in all cases where the damage is caused

¹ *Smith v. Poor*, 40 Me. 415.

Me. 415; *Allen v. Curtis*, 26 Conn.

674; *Denny v. Manhattan Co.*, 2 Denio, 115; *Forbes v. Whitlock*, 3 Edw. Ch. 446; *Smith v. Hurd*, 12 Metc. (Mass.) 371; *Smith v. Poor*, 40

456; *Tomlinson v. Bricklayers' Union*, 87 Ind. 308; *Evans v. Brandon*, 53 Tex. 56. See also *Peckham v. Van Wagenen*, 83 N. Y. 40. Compare *Kimmel v. Stoner*, 18 Pa. St. 155.

by impairing the value of the shares directly, and not through injuries to the corporate property or rights, even though every shareholder should suffer alike. Thus, if the market value of shares is impaired by false and slanderous reports, or by the issue of spurious certificates, creating uncertainty as to the title or validity of the existing shares, each holder would be entitled to recover his damages directly.¹ However, the corporation might, under these circumstances, have a separate cause of complaint for the injuries to the corporate interests; thus, if the slanderous reports were injurious to the corporate business or credit, or if the issue of spurious certificates resulted in legal liability or other damage to the company, the latter would be entitled to sue for redress.

§ 568. **Liability of Agents to Creditors at Common Law.** — Creditors of a corporation clearly have no right to meddle with the company's management, and have no cause of complaint on account of wrongful acts affecting the corporate estate, provided sufficient assets remain to satisfy their claims.² Creditors of an insolvent corporation are, however, entitled in equity to have the company's remaining assets applied in payment of their claims; and this equitable right will be protected by the courts.³ Creditors of an insolvent corporation may therefore restrain any misapplication of the company's assets, either by the board of directors, or by other persons; and they may hold the company's agents liable for wasting assets which are needed to satisfy their claims, on the ground that this constitutes a misapplication of trust funds.⁴

§ 569. **Liability of Agents for Torts.** — The agents of a corporation are clearly liable for their tortious acts; they are therefore liable for any wrongful conversion of property, or injury to property belonging to other persons. Thus, if property is

¹ *Cazeaux v. Mali*, 25 Barb. 578.

² *Infra*, §§ 795, 796.

³ *Fusz v. Spaunhorst*, 67 Mo. 256, 264; *Zinn v. Mendel*, 9 W. Va. 580; *Smith v. Poor*, 40 Me. 415; *Winter v. Baker*, 34 How. Pr. 183; *Branch v. Roberts*, 50 Barb. 435. See *Van Weel v. Winston*, 115 U. S. 228.

⁴ *Bank of St. Mary's v. St. John*, 25 Ala. 566; *Wood v. Dummer*, 3 Mason, 308; *Gratz v. Redd*, 4 B. Monr. 178, 194; *Adler v. Milwaukee Brick Co.*, 13 Wis. 62. As to the rights and remedies of creditors, see *infra*, Chapter X.

deposited with a corporation for safe keeping, or as a pledge, any agent who converts the property, or, by his wrongful acts, causes it to be lost or destroyed, is liable to the owner in damages.¹

The liability of the agent under these circumstances does not arise from any contract obligation assumed by the agent in favor of the company, or in favor of those dealing with the company; and it is entirely independent of any liability which the company may have incurred. If the company contracted to keep the property in safety, it would be liable to the owner for the breach of this contract, and if the agent doing the wrong acted within the scope of his employment, it would be liable in tort. The liability of the agent to the corporation for any damages suffered by the latter would be on account of the breach of the contract of agency; but his liability to the owner of the property would be solely for the positive misfeasance constituting a tort at common law.

Upon a similar principle, it follows that, if agents of a corporation knowingly participate in any misapplication of a fund held by the corporation in trust, they are liable in equity to the beneficiaries of the fund. But they are not liable to the owners of the fund for mere negligence in taking care of it or managing it. Their liability is no greater than that of any stranger to the company who deals with the trust property with notice of the rights of the beneficiaries. It is to be observed, however, that the corporation would have a claim against the directors for any negligence resulting in a loss of assets or a pecuniary liability; and this claim would be enforceable, on the insolvency of the company, for the benefit of those having an interest in or claim upon the corporate estate.²

§ 570. **Liability for Fraudulent Representations.** — In order to maintain an action for false representations, it is necessary to show that the representations were false, that the defendant knew the representations to be false, or made them

¹ See *United Society of Shakers v. Percy v. Millaudon*, 8 Mart. n. s. v. Underwood, 9 Bush, 609, 620. 68. *Infra*, § 795.

² *Hun v. Cary*, 82 N. Y. 65;

wilfully, without having any information as to their truth or falsity, that the plaintiff relied on the representations, and that he was misled and suffered damage in consequence. In applying this rule to an action against directors of a corporation for false representations about the company's business or financial condition, it is obviously necessary to take into consideration the peculiar position which directors of a corporation occupy. Directors may fairly be presumed to have a general knowledge of the company's management and financial condition, because it is their duty to know this. They must know that their position as the board of management of a company naturally leads the public to give credence to their statements in regard to the company, and it is their duty, therefore, not to abuse the credulity of the public by incautious statements about the matters which the public suppose to be peculiarly within their knowledge.¹

However, directors cannot be held liable for false representations, unless they were made with knowledge of their falsity, or carelessly, without due regard to the confidence placed in them. Directors are not presumed to have notice of everything relating to the organization and management of the company which they represent; they can only be presumed to know those things which would necessarily be known to them if they had performed the duties of their office. Directors are not liable if they, in good faith, publish reports based upon details furnished by the ordinary managers and clerks whom they have employed.²

§ 571. **Representations as to Authority.**—An agent incurs no liability to persons dealing with him in his representative capacity, unless he is guilty of some positive misfeasance or fraud. This rule applies to the agents of a corporation as well as to the agents of an individual or unincorporated society.³

An agent in assuming to enter into a contract on behalf of a disclosed principal does not impliedly guarantee that he has

¹ *Morgan v. Skiddy*, 62 N. Y. 400, 406. See *Shrewsbury v. Blount*, 319, 326. 2 M. & G. 475; *Addington v. Allen*, 11 Wend. 374.

² *Wakeman v. Dalley*, 51 N. Y. 27, 32; *Arthur v. Griswold*, 55 N. Y. 27, 32; *Fusz v. Spaunhorst*, 67 Mo. 256.

authority to bind the principal; and even though the contract should prove in excess of the agent's powers, and be repudiated by the principal, the agent would not be liable to the party dealing with him in the absence of any misrepresentation of facts. It is evident, however, that the execution of a contract by an agent on behalf of a principal would ordinarily involve a representation that the agent had authority to bind the principal, and the truth or falsity of this representation would be within the agent's knowledge. If an agent of a corporation should induce parties to contract with him by falsely representing the extent of his powers, or by falsely representing the existence of facts from which his authority to enter into the contract would be inferable, he would clearly be liable.¹

§ 572. An agent is not liable for an innocent misrepresentation of the law, or of the meaning of a written instrument, of which the other party has equal means of knowledge. Hence, if a person entering into a contract with an agent has legal notice that the contract is in excess of the agent's powers, the latter cannot be held responsible on the ground that the principal has refused to be bound. Charters of incorporation are usually public laws, and a person dealing with a corporation is deemed to have notice of the terms of the company's charter;² it seems, therefore, that, if a person dealing with a corporation through its agents can ascertain by reference to the company's charter that the agents have no authority to bind the corporation *under the disclosed circumstances of the case*, he cannot hold the agents responsible though their acts are repudiated by the corporation.³

The case of *Eaglesfield v. Londonderry*⁴ is a good illustration of this point. A company had issued £85,000 of pre-

¹ See *Jefts v. York*, 10 Cush. 392, 395.

² *Infra*, § 591.

³ *Abeles v. Cochran*, 22 Kans. 405; *Humphrey v. Jones*, 71 Mo. 62; *Jefts v. York*, 10 Cush. 392.

A purchaser of bonds issued by a railroad company, and secured by

mortgage upon the company's property, cannot hold the directors of the company liable for misrepresentations as to matters disclosed by the bonds or mortgage. See *Van Weel v. Winston*, 115 U. S. 228.

⁴ *Eaglesfield v. Londonderry*, L. R. 4 Ch. Div. 693.

ferred shares. The directors, under a *bona fide* belief that they had authority to issue £15,000 more, issued that amount also, and the plaintiff became the purchaser. It afterwards turned out that the issue of the £15,000 of stock was unauthorized. An action having been brought against the directors, the court held that, if the plaintiff was led by any false representation of the directors to believe that he was purchasing part of the £85,000 of stock originally issued, the directors were liable; but if the plaintiff was not led to believe that he was purchasing part of this original issue of stock, and there was a common misconception concerning the provisions of the act under which the defendants derived their authority to issue the shares, they could not be held liable.

§ 573. **Liability of Directors for publishing false Reports.** — The agents of a corporation are subject to the general rule of the common law, that a person is liable for the direct consequences of a false and fraudulent representation whereby another is misled. Thus, it has often been decided that directors are liable for fraudulent representations as to the financial condition of the company, whereby others are induced to give credit to the company, or to purchase its obligations or shares of its stock.¹ If directors issue reports or prospectuses intended for general circulation and to advertise and give credit to the company with the public, they are responsible for the natural consequence of their action in this respect; and therefore, if the reports or prospectuses are false, and were made fraudulently, any person into whose hands they come in the ordinary course of events, and who is misled thereby, has his action against the directors; it is not necessary that the misrepresentation be made by the directors directly to the party complaining.² In *Bedford v. Bag-*

¹ *Stewart v. Austin*, L. R. 3 Eq. 437; and see cases in the following 299; *Henderson v. Lacon*, L. R. 5 notes.
Eq. 249; *Ship v. Crosskill*, L. R. 10
Eq. 73, 84; *Paddock v. Fletcher*, 42
Vt. 389; *Morgan v. Skiddy*, 62 N. Y. 404; *Jarrett v. Kennedy*, 6 C. B. 319, 326; *Cole v. Cassidy*, 138 Mass. 319; *Bale v. Cleland*, 4 F. & F. 117;

² *Gerhard v. Bates*, 2 El. & Bl. 476; *Wontner v. Shairp*, 4 C. B.

shaw,¹ the defendant and others forming the board of management of a joint-stock company, for the purpose of getting the shares inserted in the official list of the Stock Exchange, falsely and fraudulently represented, through their secretary, that two thirds of the capital of the company had been paid in. The shares having been inserted in the official list in consequence of this representation, the plaintiff, knowing the requirements of the Stock Exchange, and on the faith that two thirds of the capital of the company had in good faith been paid in, purchased shares in the company. The shares having proved worthless, the court held that the defendant was liable to the plaintiff for the damages caused by the deceit.

The same rule was applied where directors rendered false reports and accounts, and pretended that dividends were being paid out of profits, when in truth no profits had been earned.²

In *Cross v. Sackett*,³ the plaintiff alleged in his complaint, that the defendants, who were the promoters and directors of a mining company, had, by means of various false and fraudulent practices and statements, set forth in detail, caused it to be generally believed in the city of New York, and by the plaintiff in particular, that the company was possessed of property worth a million of dollars; that the plaintiff, upon the faith and credit of the representations thus made by the

Clarke v. Dickson, 6 C. B. N. s. 453; *Cross v. Sackett*, 2 Bosw. 617; s. c. 6 Abb. Pr. 247.

In *Morgan v. Skiddy*, 62 N. Y. 319, 325, Andrews, J., said: "If the plaintiff purchased his stock relying on the truth of the prospectus, he has a right of action for deceit against the persons who, with knowledge of the fraud, and with intent to deceive, put it in circulation. The representation was made to each person comprehended within the class of persons who were designed to be influenced by the prospectus; and when a prospectus of this character has been issued, no

other relation or privity between the parties need be shown, except that created by the wrongful and fraudulent act of the defendants in issuing or circulating the prospectus, and the resulting injury to the plaintiff." See also *Eaton v. Avery*, 83 N. Y. 31.

¹ *Bedford v. Bagshaw*, 29 L. J. Exch. 59; 4 H. & N. 538. See also *Scott v. Dixon*, 29 L. J. Exch. 62, n.

² *Davidson v. Tulloch*, 3 Macq. App. Cas. 783; *Cross v. Sackett*, 2 Bosw. 617; s. c. 6 Abb. Pr. 247.

³ 2 Bosw. 617; s. c. 6 Abb. Pr. 247.

defendants, had purchased shares in the company from a person holding a certificate of shares issued by the company; but that the representations were false, and the shares proved worthless. The court held that these allegations disclosed a good cause of action, and that the defendants were liable to the plaintiff for his damages.

§ 574. **Liability for issuing Fraudulent Certificates.** — If directors of a corporation knowingly issue unauthorized and void certificates of shares, or invalid transferable obligations of the company, they are liable to any purchaser or subsequent transferee of the certificates or obligations who takes them relying on their apparent validity.¹ The company may likewise be liable, under these circumstances, in an action for damages, on account of the deceit practised by its agents within the scope of those duties in which the public were invited to trust them.²

¹ *Bruff v. Mali*, 36 N. Y. 200; 593, affirming *Watson v. Crandall*, National Exchange Bank *v. Sibley*, 7 Mo. App. 233; *Clark v. Edgar*, 12 71 Ga. 726; *Hornblower v. Crandall*, Mo. App. 345; *Eaglesfield v. Londonderry*, L. R. 4 Ch. Div. 693. 78 Mo. 581, affirming 7 Mo. App. 220; *Whiting v. Crandall*, 78 Mo. ² *Infra*, § 605.

END OF VOL. I.

